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Institutional Competition between Common Law and Civil Law

Theory and Policy

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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 biangeng,* 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 Boucekkine 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 appliers 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 Bakandeja 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.

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The defining structure of the project is its Steering Committee. Chaired by Yves de Cordt, it relies on an interdisciplinary section composed of members of the Faculties of Law, and of Economic, Social and Political Sciences of the University of Louvain, and an international section representing both the common law and the civil law traditions. In the former, Alain Wijfels, Patrick Wéry, Marcel Fontaine, Yves De Cordt and René Robaye lent us their support in the areas of comparative law, contract law, corporate law, and legal history respectively, Raouf Boucekkine and Frédéric Docquier on economic and econometric issues, and Amine Aït-Chaalal in political science.

The international section offers us the crucial element of balance in our effort to take up the challenge of legal origins theory to the theory of functional convergence between common law and civil law. It is made up of legal scholars representing the English, French, and German legal origins as well as Japan and the US, two countries which have merged common law and civil law traditions and created "legal origins" of their own by serving as models for other countries. Kenneth Dam represents the great tradition of American comparative law at the University of Chicago in the lineage of Max Rheinstein. As a Deputy Secretary of the Treasury from 1985 to 1989, he took part in the management of the American economy at a crucial juncture, personifying the relationship between law and economics owes its emergence to legal origins theory. Representatives of institutional economics might resent that implication since their field emerged already in the 1930s. His critique of legal origins theory in his 2006 book "The Law-Growth Nexus: the Rule of Law and Economic Development" was a decisive impetus for initiating our project. His participation in our first workshop in March 2009 and continuing advice since then provided invaluable inspiration. Simon Deakin and his colleagues at the Cambridge Center for Business Research (CBR) led the way from static cross-country analysis of the economic impact of common law and civil law as championed by legal origins theory to analysis of legal change over time. His participation in our conference on access to justice in February 2012 was a step towards creating a critical mass on the basis of which a much-needed international academic network of research and data collection could emerge as an alternative to the networks of law firms on which legal origins theory relies. Seigo Hirowatari contributed the crucial voice of legal sociology to our early debates before being absorbed by his duties as President of the Japanese Science Council. His focus on the fault-lines between law and society sharpened our perception of the problems involved in legal transplants and of the necessity of permanent mutual adaptation between the social and the legal process. Bertrand du Marais represented the French legal origin, the preferred target of legal origins theory, with the superb poise of an analytical swordsman. Taking leave from his duties as a Conseiller d'État, he took up the challenge by founding the interdisciplinary Centre d'étude "attractivité économique du droit" at the French ministry of justice, unafraid to compare strengths and weaknesses in both civil and common law. We owe a lot to his intellectual courage and support.

We are grateful to the Japan Foundation for its financial support of the two conferences. The first, in March 2009, served to map the major methodological issues; the second, in February 2012, focused on access to justice, econometric analysis, issues of legal cultures, and strategies for legal reforms in developing and transforming countries. We thank Helen Ahrens, Grégoire Bakandéja, Shairai Batsukh, Harald Baum, Erhard Blankenburg, Raouf Boucekkine, Sofie Cools, Kenneth Dam, Simon Deakin, Yves De Cordt, Frédéric Docquier, Victoria Elliot, Helmut Fessler, Marcel Fontaine, Linn Hammergren, Seigo Hirowatari, Masayoshi Kanda, Masahiro Kawai, Rolf Knieper, Jayanth K. Krishnan, Yoshiki Kurumisawa, Bertrand du Marais, Hiroshi Matsuo, Yukio Nakajima, Fabien Ngendakuriyo, Bert Niemeijer, Denis Philippe, Hans-Joachim Schramm, Alexander Schubert, Otmar Stöcker, Albrecht Stockmayer,

Pierre-Paul Vangehuchten, Claus Vreden, Patrick De Wolf, and Stéphane Zecevic for their participation and contributions. Some of the latter evolved through further research, first into working papers of the Joint CRIDES, IRES, CECRI Working Paper Series on "Institutional Competition between Common Law and Civil Law" at the UCL established in 2009 and finally into chapters of this book.

The idea for this project began emerging in surprised reaction to the spontaneous and urgent demand of Eastern European, Central Asian, and East Asian countries for Western advice in their legal transformation after the fall of the Berlin Wall. Both editors had to deal with this demand in their respective professions, Michèle Schmiegelow as a teacher of international relations theory at the UCL, Henrik Schmiegelow as a foreign policy advisor of the President of the Federal Republic of Germany. We plead guilty of having naively believed, initially, that the entire Western donor community should respond to this demand, each country as best it could, both multilaterally and bilaterally, through both governmental and non-governmental institutions and with both civil law and common law as rich sources of advice. Only when legal origins theory emerged in the late 1990s did we realize that institutional competition, on principle a functional process of discovery, could become an issue of political debate within the donor community.

It helped that professional reasons allowed both editors to spend 5 years in Japan, from 2001 to 2006, a country standing out as a paradigm of autonomous and selective choice of foreign and domestic patterns in its own legal transformations of the late nineteenth century and, again, in the postwar period. Fascinating discussions with the late Akira Mikazuki, who as Minister of Justice in 1993–1994 had initiated the first programs of Japanese assistance to legal reforms in transforming countries in East Asia, as well as Tokiyasu Fujita and Hiroshi Fukuda, justices of the Supreme Court of Japan, opened our eyes to the fact that Japan's experience was invaluable both for transforming countries and for donor countries responding to the demand of transforming countries for advice in legal reforms. Without being aware of it and, hence, without involving their responsibility, these three great Japanese scholars and practitioners of law gave a decisive impulse to this project. This is the time for us to express our gratitude.

Conferences and discussions at the Center of Asian Legal Exchange (CALE) of the University of Nagoya in 2006, the University of Bochum in 2007, the German Ministry of Justice in 2008 and 2009, the Deutsche Stiftung für internationale rechtliche Zusammenarbeit (IRZ) in 2008, the Fondation pour le droit continental in Paris in 2008, the Japanisch-Deutsches Zentrum Berlin (JDZB) in 2009, the Hangzhou Forum in 2009 and 2010, the Chinese Academy of Social Sciences and the Center for China in the World Economy (CCWE) at Tsinghua University in 2009, the Civil Law Forum for South East Europe in Cavtat in 2010, the Conseil supérieur du notariat (CSN) in Paris in 2010, the Forum sur les institutions, le droit, l'économie et la société (FIDES) in Paris 2010, a joint Symposium of the Alexander von Humboldt Foundation, the German-Japanese Association of Jurists and Keio University on "Transfers of Laws" in Tokyo in 2011, and the Fondation Universitaire in Brussels in 2013, helped in broadening the conceptual, empirical, and organizational basis of the project. Our thanks go to Masanori Aikyo, Karl

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Abbreviations

ABS	Asset-backed Securities
ADB	Asian Development Bank
ADHGB	Handelgesetzbuch (Germany)
ADR	Alternative Dispute Resolution
AIBE	All India Bar Exam
AMC	Asset management Corporation
AusAID	Australian Agency for International Development
BACK	Bar Association of the Kingdom of Cambodia
BCI	Bar Council of India
BGB	Bürgerliches Gesetzbuch (Germany)
BGR	Bundesgerichtshof (Federal Court of Justice) 1950, 1990 for united Germany
BJS	Bureau of Justice Statistics (US)
CalCCP	California Code of Civil Procedure (US)
CCJA	Common Court of Justice and Arbitration
CDO	Collateralized Debt Obligation
CDR	Cultural Dispute Resolution
CDRAC	Corporate Debt Restructuring Advisory Committee (Thailand)
CDRC	Corporate Debt Restructuring Committee (Malaysia)
CDS	Credit Default Swap
CEDEAO	Communauté économique des États de l'Afrique de l'Ouest (Economic Community of West African States)
CEMAC	Communauté économique et monétaire de l'Afrique Centrale (Economic and Monetary Community of Central Africa)
CEPEJ	European Commission for the Efficiency of Justice
CIDA	Canadian International Development Agency
CISG	United Nations Convention on Contracts for the International Sale of Goods
CNKI	China National Knowledge Infrastructure
COSCA	Conference of State Court Administrators (US)

CPC	Civil Procedure Code (France)
CPI	Corruption Perception Index
CPIA	Country Policy and Institutional Assessment (World Bank)
CRCC	Corporate Restructuring Coordination Committee (South Korea)
CSIP	Capital Structure Improvement Plan (Korea)
CSP	Court Statistics Project (US)
DB	Doing Business Reports of the World Bank-IFC
DICJ	Deposit Insurance Corporation Japan
DRH	Default Rule Hypothesis
EWI	Employing Workers Indicator
FASB	Financial Accounting Standard Board
FHI	Freedom House Index
FRA	Financial Sector Restructuring Authority
FRCP	Federal Rules of Civil Procedure (US)
FSA	Financial Services Agency
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für internationale Zusammenarbeit (Germany)
HDI	Human Development Index
HGB	Handelsgesetzbuch (Germany)
IAS	Indian Administrative Service
IBRA	Indonesian Bank Restructuring Agency
ICRG	International Country Risk Guide
IEG	Independent Evaluation Group (World Bank)
ILO	International Labor Organization
IMF	International Monetary Fund
INDRA	Indonesian Debt Restructuring Agency
IRCJ	Industrial Revitalization Corporation of Japan
J4P	World Bank's Justice for Poor initiative
JFBA	Japan Federation of Bar Associations
JICA	Japan International Cooperation Agency
JITF	Jakarta Initiative Task Force (Indonesia)
KCPA	Korea Civil Procedure Act
LBA	Lao Bar Association
LCI	Law Commission of India
LLSV	La Porta, Lopes-de-Silanes, Shleifer, Vishny
LOT	Legal Origins Theory
LTC	Lawyers Training Center (Cambodia)
MBS	Mortgage-Backed Securities
MDBs	Multilateral Development Banks
MJSSH	Minjishosho-ho (civil procedure code) (Japan)
NCCUSL	National Conference of Commissioners on Uniform State Laws
NCSC	National Center of State Courts (US)
NEP	New Economic Policy (USSR)
NPC	National People's Congress (China)

NPL	Non Performing Loans
OAB	Brazilian Bar Association
OHADA	Organisation pour l'harmonisation en Afrique du droit des affaires (Organisation for Harmonization of Business Law in Africa)
OPM	Office of Personnel Management (US)
PEH	Procedural Efficiency Hypothesis
PIL	Public Interest Litigation
RAB	Radanasin Bank
RCC	Resolution and Collection Corporation (Japan)
RCT	Randomized Control Trials
RG	Reichsgericht (Supreme Court) 1879–1945 (Germany)
RSJP	Royal School for Judges and Prosecutors (Cambodia)
SAL	Social Action Litigation
SCI	Supreme Court of India
SCNPC	Standing Committee of the National People's Congress (China)
SEC	Securities and Exchange Commission (US)
SIDA	Swedish International Development Cooperation Agency
SPC	Supreme People's Court (Vietnam and China)
TAMC	Thai Asset Management Corporation
TARP	Troubled Asset Relief Program
TCCP	Taiwan Code of Civil Procedure
UCC	Uniform Commercial Codes (US)
UEAC	Union économique en Afrique Centrale (Economic Union In Central Africa)
UEMOA	Union économique et monétaire de l'Ouest Africain (West African Economic and Monetary Union)
UMAC	Union monétaire en Afrique Centrale (Monetary Union in Central Africa)
UNDP	United Nations Development Program
UNHCR	United Nations High Commission for Refugees
UNHDI	United Nations Human Development Index
UNTAC	United Nations Transitional Authority in Cambodia
UPSC	Union Public Service Commission
VBA	Vietnam Bar Association
WB	World Bank
WPI	Worker Protection Indicator (World Bank)
ZPO	Zivilprozessordnung (Germany)

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Part I
Introduction

Chapter 1
Interdisciplinary Issues in Comparing Common Law and Civil Law

Michèle Schmiegelow

1.1 The "Comparative Quality" of Common Law and Civil Law as an Issue of Policy

For half a century after the end of the Second World War, agreement on the necessity of law as a framework for liberal democracy and the free market economy anywhere in the world was widespread in the Western value community (Schmiegelow 1997). After the end of the cold war, Western assistance to legal reforms in former East bloc countries was thus a natural political commitment both in Europe and America. Since the end of the 1990s however, a debate on the right choice between common law or civil law patterns appears to deprive such commitment of some of its a priori legitimacy.

1.1.1 Law in the Philosophy of the Open Society and in Institutional Economics

For the two leading thinkers of the twentieth century on the concept of an open society, Karl Popper and Friedrich von Hayek, law had to play a crucial role in the transformation of any society from absolutism, authoritarianism or totalitarianism to a liberal democracy and a free market economy. As a preface to the first Russian edition (1992) of his celebrated 1945 treatise *The Open Society and its Enemies*, Popper referred to the successful example of Japan's joining the European civil law codification movement in the 1890s as a pattern for its legal framework for rapid modernization. He urged Russia to emulate the Japanese example by rapidly

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adopting a civil code. Hayek published his *Law, Legislation and Liberty* in 1973, at a time when development theory in the US seemed oblivious to law, and the lament of this was widespread among American legal scholars. In the 1990s, new institutional economics emerged with evidence that legally binding contracts (Coase 1988) and, more generally, a reliable legal framework for markets (North 1990) can reduce economic transaction costs.

1.1.2 Spontaneous Transformation Assistance After the End of the Cold War

Thus encouraged, the transformation assistance from Western donor countries developed as a spontaneous reaction to the fall of the Berlin Wall. Civil law countries such as France, Germany and Japan responded to demands from the transforming countries of the former Eastern Bloc for assistance in their legal reforms. They built upon their own part in the codification movement of the nineteenth century as well as on experience of assistance to legal reforms in developing countries after the Second World War. Most of the transforming countries did indeed adopt civil codes and commercial codes. While following basic patterns of the French, German or Japanese codes that seemed to have proven their functional quality by the test of time, they endeavored to adapt them to the cultural and economic context of their own societies. At the same time, common law countries have been proactively offering advice on legal reforms in many of the same transforming countries. The supply of US templates became particularly influential in the area of economic legislation.

There was no significant degree of coordination in these aid efforts. If there was competition between Western advisors on particular projects, it was not initially perceived as an institutional competition between common law and civil law systems, but rather between national bilateral aid programs, aid agencies, foundations, individual consulting firms or even just eminent legal scholars. Only about one decade later, did the issue of common law and civil law sources of advice working at cross-purposes emerge as a problem of policy choice.

1.1.3 The Recent Debate on the Comparative Quality of Common Law and Civil Law

To the surprise of aid agencies and legal communities of major civil law donor countries, the yearly "Doing Business" Reports of the World Bank (DB) began to imply sweeping challenges to civil law systems in the early 2000s and have continued to do so ever since (World Bank-IFC 2013). This sudden shift of opinion reflected the growing influence of a group of political scientists and economists

commonly referred to as LLSV (after the initials of the family names La Porta, Lopez-de-Silanes, Shleifer and Vishny) on the section of the World Bank staff in charge of the DB. Based on an unconventional combination of sociology of religion, legal history, political theory and econometrics, this group argued that protestant common law countries were better governed and offered superior business environments than civil law countries of French or German "legal origin", with Latin American countries summarily counted as members of the group of countries of "French legal origin", and China, Japan and the Republic of Korea as of "German legal origin" (La Porta et al. 1997, 1998). In the following decade, this argument was the subject of a large body of supporting and qualifying literature as well as of a major restatement by the first three of the initial four authors in the *Journal of Economic Literature* (La Porta et al. 2008). Since then it is usually referred to as "Legal Origins Theory" (LOT).

Institutional competition between common law and civil law is legitimate and desirable as long as it is open and unimpaired. Given the global institutional influence of the World Bank-IFC, its adoption of LOT elevates this approach from the status of an unconventional academic argument to that of a fundamental political challenge to civil law donor countries as well as to their efforts to assist transforming and developing countries. Transforming or developing countries initiating or continuing reforms of their legal systems will hesitate to follow advice inspired by civil law, since most of them depend either on financial support of the World Bank or on private investment attentive to World Bank opinion. They will be all the more hesitant as the reports of the World Bank are used as references in the country analyses of the major rating agencies and, hence, have a powerful impact on their international creditworthiness. Without a thorough examination of the methodology of LOT and the DB of the World Bank, institutional competition between common law and civil law appears impaired.

Reactions from civil law countries remained subdued, up to the present. The French Ministry of Justice did initiate a program on "attractivité économique du droit" headed by Bertrand du Marais, Conseiller d'État, which took issue with the poor scores metropolitan France obtained in the rankings of the World Bank's DB and the country analyses of rating agencies (du Marais 2006; du Marais et al. 2007). It addressed the general methodological issue of measuring the economic impact of law and institutions (Ménard and du Marais 2006), but it did not raise the problems of imperial transplantation of foreign legal systems to unreceptive colonies or of assistance to today's developing and transforming countries. Germany and Japan remained active in the area of transformation assistance. But there was no organized response to the fundamental challenge of LLSV and the World Bank. The *Zeitschrift für japanisches Recht/Journal of Japanese Law*, which is edited at the Max Planck Institut für ausländisches und internationales Privatrecht in Hamburg published an article on German and Japanese transformation assistance containing a short academic critique of the LLSV methodology (Schmiegelow 2006).

Significantly, more ample critical analyses of the LLSV approach appeared in common law countries. In a series of working papers, researchers at the Center for Business Research at the University of Cambridge argued that LLSV econometrics

contained biases masking dysfunctional conditions in US and UK corporate governance while amplifying negative aspects of the business environment in civil law countries (Ahlering and Deakin 2007; Armour et al. 2007). At the Brookings Institution, Kenneth Dam identified weaknesses of LLSV such as their mistaken treatment of Latin American countries as of "French legal origin", insufficient attention to contract law, as well as econometric anomalies. Moreover, he raised the intriguing question of whether China's extraordinary growth since espousing the market economy did not cast doubts on the nexus between law and development as assumed by Popper, Hayek, and new institutional economists as well as LLSV (Dam 2006). On the other hand, China's extraordinary growth rates of the 1990s and 2000s cannot simply be projected into the future and the demand for law may become more pressing as the Chinese economy enters a development path of more balanced growth.

Finally, in a remarkable evaluation published in June 2008, the World Bank's Independent Evaluation Group (IEG) recognized a number of methodological problems of the DB (World Bank-IEG 2008). More particularly, it questioned their exclusive focus on the cost of regulations for individual firms without consideration of their intended social benefits or development goals. It did notice that the base of informants (70 % representatives of globally active private law firms, only one or two of these for each indicator in each of the 178 countries) was far too small to warrant impartial results. It found fault in the lack of transparency of the way in which the World Bank-IFC DB staff processes the data obtained into country rankings, and arrives at changes in rankings over time. The IEG recommends different procedures for the selection of, and improved methodologies for research on new indicators before their global publication by the World Bank. However, it does not address the problem of the harm that may be caused by the continued publication of the ten indicators used with a deficient methodology by the DB. On the contrary, it commends World Bank-IFC for its assertive marketing of the DB. The problem of distortion of institutional competition between common law and civil law is therefore not resolved by the World Bank-IEG's otherwise most useful evaluation.

In an implicit departure from the "legal origins approach" of LLSV, the World Bank-IEG (2008) conceded that a hypothetical civil law country combining the highest scores of the highest-scoring civil law country on each of the ten indicators would reach third place in the overall ranking. In her presentation at the workshop "Institutional Competition between Common Law and Civil Law" at the Université Catholique de Louvain on March 10, 2009 Victoria Elliott, the principal author of World Bank-IEG evaluation, took particular issue with the Employing Workers Indicator (EWI) of the DB, identifying inconsistencies between the EWI's focus on the cost of employing workers and its claim to observe ILO standards (Elliott 2009). In a remarkable reversal, the World Bank Group published a note on April 27, 2009 stating that: "the EWI does not represent World Bank policy and should not be used as a basis for policy advice or in any country program documents that outline or evaluate the development strategy or assistance program for a recipient country". The note expressed a commitment to remove the EWI from the World Bank

Group's Country Policy and Institutional Assessment (CPIA) record, review EWI, develop a new Worker Protection Indicator (WPI), and ask a new consultative group to offer broader ideas on labor-market issues to promote regulations designed to build robust jobs with adequate worker protection (World Bank IFC 2009).

These developments show that The World Bank Group, while maintaining the DB as one of its "flagship publications" (World Bank IFC 2009), is open to methodological critique. It is therefore worthwhile to extend such critique beyond the EWI, review all other nine indicators used in the reports in the light of the findings of World Bank IEG, develop new indicators helpful in orienting legal reforms, and replace the distorting method of simply averaging indicators for country rankings with indicators weighted according to their relevance for economic and legal policies. Basic assumptions of LLSV's political theory, religious sociology, economic model and econometric approach, which transcend the methodology of the DB, need to be thoroughly examined with the full cognitive resources of each discipline either boldly implicated, or summarily disregarded, by LOT.

1.2 Problems of Political Science, Sociology, Economics, Law and History

The academic communities of the countries concerned should provide the material for transparent institutional competition between common law and civil law. As LOT and the DB take an interdisciplinary approach, so must any debate taking issue with their conclusions or any policy at variance with their recommendations. As is the case for all discussions on economic development, the debate needs the involvement of political scientists, economists and sociologists as well as legal scholars.

If "legal origins" are supposed to influence development, particular attention must be paid to political theory, international relations theory, institutional economics, the theory of economic development, econometrics, comparative law, the sociology of law, legal history and, more particularly, the history of failed and successful legal transplants. This is suggested by the different methodological problems of the LOT and World Bank approaches on which critical analyses published so far have focused, and more particularly on:

1. the inability of static cross country analysis such as LOT's to capture the economic effect of legal changes over time (Schmiegelow 2006; Armour et al. 2007, Chaps. 2, 3, 5, 15, and 18)
2. the heavy price LOT must inevitably pay in terms of thoroughness of legal analysis to obtain the econometric robustness derived from its samples of over 100 countries (Boucekkine et al. 2010; Schmiegelow 2013; Kawai and Schmiegelow 2013, Chaps. 3, 5, 15, and 18)

3. the lack of detailed legal analysis of shareholder protection rules of substantive corporate law in countries central to LOT's assertion of common law superiority for financial markets (Cools 2005; Braendle 2005)
4. LOT's and DB's method of measuring comparative efficiencies of common law and civil law judiciaries exclusively based on data of the duration of court procedures obtained from international networks of law firms, which masks the basic cost and time inefficiency of lawyer-dominated common law procedure lamented by the most authoritative American scholars of comparative civil procedure (Kaplan et al. 1958; Langbein 1985) and eminent authors of proposals for reform of English civil procedure (Lord Woolf 1996; Lord Jackson 2009, Chap. 5)
5. LOT's association of common law procedure with the postulated ideal of litigants having their dispute settled by their common neighbor (Djankov et al. 2002) is seriously undermined by the abolition of the civil jury trial in England and Wales in 1933 (UK Administration of Justice (miscellaneous provisions) Act 1933) and by its "vanishing" (Galanter 2004, p. 459) over the past 100 years in favor of lawyer-brokered settlements and other alternative modes of dispute resolution in the US (Schmiegelow 2013, Chap. 5)
6. a major inconsistency between the superiority, recognized by LLSV (La Porta et al. 1999, 2008), of average long-term economic performance of countries coded by LOT as of "German legal origin" since the 1960s as compared to common law countries and the "political theory" (La Porta et al. 1999), nonetheless maintained by its authors, that the quality of government of common law countries is superior (Schmiegelow 2006, Chaps. 3 and 5)
7. significant misunderstandings of the history of Roman law, such as its overriding concern for the protection of private property (Zimmermann 1996; Robaye 1997), of common law, such as its debts to Roman law (Hayek 1973), and of civil law, such as the economic liberalism of the French, German and Japanese civil codes (Zimmermann 1996; Schmiegelow 2006; Ahlering and Deakin 2007, Chaps. 3, 5, and 18)
8. a sociology of religion based on Robert Putnam's thesis that protestants have more trust in strangers than Catholics (Putnam 1993), but as obviously refutable as Max Weber's protestant explanation of capitalism by the histories of mediaeval bankers like the Medici, Fuggers and Welsers as well as contemporary Japanese and Chinese capitalism (Schmiegelow and Schmiegelow 1989). While trust of investors in the management of corporations may be a condition of their decision to buy shares of that corporation and hence play a functional role in economic performance (Roe 2006), the theory of bubbles and financial crises shows how dysfunctional such trust may become, if it is based on irrational expectations (Shiller 2000), or, as in the subprime crisis, expectations considered rational by flawed models of financial engineering (Schmiegelow and Schmiegelow 2009, Chaps. 4, 5, and 15)
9. the insufficient attention to the institutional economics of contract law, balancing the synallagmatic interests of contracting parties such as producers

and consumers, owners and tenants, employers and workers, creditors and debtors (Dam 2006; Schmiegelow 2006, Chaps. 3 and 6)
10. weaknesses in comparative law such as the coding of Latin American legal systems as being of "French legal origin" (Dam 2006, Chap. 8)
11. failure to consider that international relations theory requires a distinction be made between colonial transplants of law as in most developing countries of the former British and French empires and the voluntary participation of independent countries such as Switzerland, Japan and Thailand in the European codification movement of the late nineteenth and early twentieth century (Berkowitz et al. 2003; Schmiegelow 2006, Chaps. 2, 3, 5, 7, 8, 9, 10, and 15)
12. the risk involved in large samples of countries with overwhelming majorities of former colonies of unwittingly measuring the negative "transplant effect" (Berkowitz et al. 2003) of imperial imposition of foreign legal systems to unreceptive countries rather than the intrinsic qualities of English common law or French civil law (Schmiegelow 2013, Chaps. 5, 7, 8, 9, 10, and 15).

1.3 The Importance of Refocusing on the Primary Sources of Institutional Economics

To refocus the debate on the benefits of legal reforms in industrialized, emerging, transforming and developing countries alike, a return to the original focus of institutional economics appears necessary, i.e. the transaction cost reducing role of reliable contracts and regulatory frameworks for free markets balancing the interests of producers and consumers, owners and tenants, creditors and debtors, employers and employees, shareholders, stakeholders and management of corporations. Common law and civil law traditions—whatever their differences in style and jurisprudence—share a commitment to the rule of law as a universal good. Both have been adapted in countless ways to the cultures and economic conditions of individual societies including those of their countries of origin. The demand for law in the "mother countries of legal origins" as well as in today's emerging, transforming and developing countries implies the expectation of such adaptability. Provided they are responsive to that expectation, both common law and civil law traditions can serve as reservoirs of functional solutions for legal reforms in any type of country and in interaction with any cultural context.

1.3.1 The Need for a Reassessment of the Functional Qualities of Modern Civil Law Systems

While comparative lawyers have used functional analysis as a method of comparative law for a long time (Dannemann 2006), few of them would be inclined to take the dazzling use of econometric regressions of a conspicuously limited selection of

indicators as a measure of the functional quality of common law or civil law seriously. Yet, there is growing awareness that the challenge of LLSV and the World Bank-IFC needs to be met in the arena which they have chosen, i.e. a very basic sociological functionalism, quantified by indicators easily measured by econometric regressions and controlled by the logarithm of per capita GDP of the countries compared.

The German and the Japanese civil codes and civil procedure codes offer particularly interesting material for comparative functional analysis as they have stood the test of time in more severe conditions than most transforming countries today. They provided an immediately available institutional framework for the economic revival of two countries more completely destroyed in the Second World War than any other country in any previous war (Schmiegelow and Schmiegelow 1989; Schmiegelow 2006). Prima facie, they appear better suited to help "jump start" economic development in transforming and developing countries than a strategy of waiting for a slow process of judge-made law emulating the history of common law. The economic histories of divided countries such as postwar China, Germany, the Republic of Korea or India and Burma/Myanmar as successors of British India can serve as quasi "natural experiments" permitting the measurement of the causal effect of institutions on economic development in a much more reliable way than LOT's static cross country analyses (Acemoglu et al. 2005; Boucekkine et al. 2010; Docquier 2012, Chaps. 2, 3, and 5).

It is especially rewarding to compare the functional quality and minimal transaction cost of the default rules offered by contract law in civil codes to all citizens who do not wish, or cannot afford, the legal advice necessary to draw up specific provisions from voluminous compendia of precedents needing to be referred to in order, at great cost, to make contracts safe against the risk of disputes before common law courts (Boucekkine et al. 2010, Chap. 3). In this context, it is significant that US scholars of contract theory have recently begun to focus on the merits of relying on such default rules as a legislative technique in the US as well (Barnett 1992).

The subprime crisis suggests the salience of mandatory general clauses in the negotiating phase of concluding contracts. Civil codes contain general clauses on "good faith" denying enforceability of contracts based on severe information asymmetries, if enforcement would breach the trust of the uninformed party (Farnsworth 1987; Nedzel 1997). Common law judges have traditionally refused to accept such limits on the behavior of contracting parties (Farnsworth 2006). Unwarranted trust of homebuyers in mortgage brokers ready to overextend credit to clearly overburdened borrowers is now recognized in both common law and civil law countries as one of the main causes of the crisis. This is also the case of unwarranted trust of investors in the AAA rating of securities collateralized by such mortgages (Schmiegelow and Schmiegelow 2009). Robert Shiller of Yale University has suggested that the institution of a civil law notary in the US might have helped mitigate the information asymmetry between homebuyers and mortgage brokers (Shiller 2008). The two editors of this book argue that general clauses of the civil law type and their effective enforcement might have prevented massive

foreclosures for homeowners and hence enormous transaction cost as well as macro-economic cost (Schmiegelow and Schmiegelow 2009, Chap. 4).

Inversely, under the impact of the consumer protection movement in the US, the private autonomy of contracting parties in the civil codes of France and Germany was significantly reduced by EU legislation requiring member-states to revise their civil codes so as to condition the validity of sales contracts in complex procedures increasing the transaction costs of both producers and consumers (Boucart 2005; Riesenhuber 2007).

High degrees of creditor protection and of contract enforcement in Germany and Japan are already attested by LLSV themselves, one of the inconsistencies calling into question the broad sweep of their conclusions. Creditor protection in German and Japanese corporate law even turned out to be a step too far for the public good. It ended up by being criticized as an impediment to the setting up of new businesses and was, or is being, lowered in both countries (Bundesministerium der Justiz 2009; Baum 2001).

Property rights and debt enforceability is one of the major concerns of both LOT and DB. The "Registering Property Index" (RPI) is one of seven of the ten indicators of ease of doing business where the top ranking countries are those with the prima facie fewest requirements and lowest costs. But comparative econometric studies of two major property conveyancing and titling systems have revealed that apparently simple recording systems such as the American and French ones, where it is sufficient to deposit the agreement to acquire a real estate property at the County recording office, in the end is a much more costly and much less safe method of property conveyance than a public registry such as in Australia, Denmark, Germany and Spain, when the ownership of the seller comes to be questioned. For, while recording offices must accept all signed documents whatever their legality and their collision with preexisting rights, public registration of a new right requires a purge of all older preexisting contradictory rights (Arrunada and Garoupa 2005; Arrunada 2011, 2012a, b). In most civil law countries with a public registry system, the notary authenticating the property sale or mortgage is bound by law to examine the legality of the contract and the absence of contradictory rights before conveying it to the registry. In the American recording system, title examiners are needed to examine all deeds dealing with the concerned parcel of land in the past and to certify the legality of the document in question. This is lucrative for title examiners, but the risk of legal uncertainty remains with their clients. In the subprime crisis, millions of mortgages packaged in asset-backed securities required title searches as subprime borrowers became unable to service their debt. Hernando de Soto, the Peruvian scholar of the deficiencies of property law in developing countries, has compared the US recording system to dysfunctional conditions in Latin America (De Soto 2009). It turned out to be a major structural impediment to rapid crisis resolution (Chap. 4). Evidently the RPI needs to refocus on the comparative advantage of public recording systems for any country like the US determined to rely on financial innovation for economic growth. Only a public recording system makes securitization of mortgages and trade in such securities possible, as any lender, any investor and any holder of mortgages and similar property assets

can check the identity and contents of the asset involved in the public registry at any time (Schmiegelow and Schmiegelow 2009). Significantly China's new property law has opted for a public registry system (Rehm and Hinrich 2009).

Shareholder protection against corporate insiders was initially another of the major areas where LLSV assumed common law countries to be superior to civil law countries. Prompted by studies detailing Belgian, French and German shareholder rights functionally equivalent to common law anti-director rights (Cools 2005; Braendle 2005), LLSV replaced the anti-director rights standard by indicators such as securities laws governing new rights issues and corporate laws preventing self-dealing transactions by insiders (La Porta et al. 2008).

Both the US and the UK recognized the need of reforming their take-over rules in the 1960s. Since very different interest groups reflecting the different economic structures of the two countries at the time (still preponderantly industrial in the US, predominantly financial in the UK) supported the reform in the two cases, the results are very different, enabling shareholders to delay and impede a takeover in the US, while ruling out any attempt to frustrate it in the UK (Baum 2009). In various combinations, France, Germany and Japan have adopted elements of one or the other, or both. There is no longer any common law/civil law divide (Armour et al. 2007). Moreover, control by the logarithm of per capita GDP does not confirm superior quality of either the US or the UK solutions as compared to the corporate law regimes of civil law countries as a group. In its latest restatement, LOT admits that Germany's and Japan's average economic performance exceeded that of the US and UK since the 1960s, i.e. since the corporate law reforms in the US and UK (La Porta et al. 2008).

Germany's and Japan's superior average long-term economic performance must be all the more intriguing from LOT's point of view, since the financial sector of these two countries has been marked by indirect financing of corporate investment through banks rather than the direct financing from the capital market (Schmiegelow and Schmiegelow 1989). Indirect finance has been regarded as backward by generations of economists following in that respect Alexander Gerschenkron's theory of backwardness (Gerschenkron 1962) and it is not surprising that LOT took the capital market model prevalent in the US and the UK as an axiomatic standard. More recent analysis of financial intermediation takes a more balanced view, however, finding virtue in the banks' traditional role of reducing information asymmetries between providers and receivers of capital. They should (ideally) also be safer in absorbing inter-temporal risk for household savings and in monitoring management performance in "relationship banking" with small and medium enterprises (Schmidt et al. 1998). "Old-style" financial intermediation by commercial banks may have been more functional than the "innovative" securitization driven by US investment banks after all (Rajan 2005).

Whatever the judgment of history of these different financial systems may be in the end, however, they can no longer be linked to "legal origin". France has made great strides in the process of disintermediation recommended by the IMF and the World Bank as a global standard. Securitization both on the asset and the liability side of French non-financial sectors indicates that France has been changing from a

bank-based to a market-based financial system ever since the early 1980s (Schmidt et al. 1998).

The worst regression results France and Germany got in the World Bank-IFC DB (2008) are to be found for the indicator "Employing Workers" (EWI), with ranks 144 and 137 respectively of 178 countries. Their statistical impact on the un-weighted average of the ten indicators of the report largely accounts for the modest ranks 31 for France and 20 for Germany, whereas common law countries offering freedom of hiring and firing hold the first four ranks. The evaluation of World Bank-IFC "Doing Business" by World Bank-IEG (2008) mentioned above singled out EWI (since removed) as the most important common negative factor in the ranking of European civil law countries, even if Scandinavian countries were categorized as civil law countries. But labor regulations are not part of the civil code in either country. They result from particular social legislation reflecting policies of distributive justice and/or Keynesian notions of automatic demand stabilizers in mature economies. Except for remnants of life-time employment and seniority wages, Japan's labor market is much less rigid, even though Japan is coded by LOT as a civil law country of German legal origin. This suggests that the labor market may be a telling category for LOT political theory and for current World Bank IFC economic analysis, but certainly not for wider categories of institutional competition between common law and civil law, such as the United Nations Human Development Index (Deakin et al. 2013, Chap. 6).

Evidently, the number of indicators for comparing the quality of "legal origins" needs to be increased. Moreover, the particular value of each indicator is lost, if all indicators are simply averaged in the country rankings of the World Bank reports. They need to be weighted to provide meaningful answers to every single policy question transforming and developing countries must contend with in their search for functional solutions in their legal reforms.

The level and distribution of the cost of litigation as well as of fees for legal advice are not only important for measuring the ease of access to law as an important condition of the rule of law. They also constitute an important part of transaction costs in terms of institutional economics. This is a crucial issue for research in institutional competition between different "legal origins" to provide advice to transforming and developing countries. In view of salient differences between the UK and the US, as well as between Latin countries, Germany and Japan, as concerns rules on court costs and lawyer's fees, here again, the simple dichotomy between common law and civil law will not be helpful (Schmiegelow 2013, Chap. 5).

1.3.2 Recognizing the Convergence of Common Law and Civil Law

The institutional competition between common law and civil law could lead to more focused policy choices in transforming and developing countries, if the comparison of their functional qualities could identify what they have in common in addition to what makes them different (Zweigert and Kötz 1998; Dannemann 2006).

Indeed the most important feature in the relation between civil law and common law is the expanding role of legislated law in common law countries and the growing importance of judge-made law in civil law countries. In modern societies such as the US, the UK, France, Germany and Japan (to name only some of the most important donor countries of transformation and development assistance), there is intense interaction between legislative and judicial powers. Court rulings fill gaps in legislation or even correct dysfunctional legislation in civil law countries. Inversely, statutes in common law countries bind judges more strictly than civil law codes which provide judges with ample opportunity to become "sources of law" thanks to numerous "general clauses" (Dannemann 2006; Schmiegelow 2006; Schmiegelow and Schmiegelow 2013). Research on these functional interactions between two of the three components of Montesquieu's division of powers, as well as advice based on such research will be particularly helpful for transforming and developing countries in the process of reforming their legal system. As Boucekkine et al. (2010) have shown, such institutional convergence is suggestively reflected in the converging evolution of GDP pc of the developed civil law and common law countries just mentioned (Chaps. 3 and 18).

1.3.3 Measuring Transaction Costs, Comparing Macro-Economic Performance and Locational Quality Indicators with Improved Methodology

Econometric and macro-economic analysis will need to be applied to measure transaction costs and compare macro-economic performance of common law countries and civil law countries over the time horizons of the 200 years of the French code civil and the 100 years of the German BGB and Japanese civil code (Chap. 3). In the cases of more recent reforms, such as US and UK revisions of corporate law in the 1960s, as well as German and Japanese reforms, which have adopted different elements of US or UK patterns, the time horizons will need to be adjusted accordingly.

Periodically recurring financial crises emanating from insufficiently supervised capital and real estate markets in the US and the UK need to be analyzed as thoroughly as rigidities in the labor markets of civil law countries from the point of view of institutional economics, without masking these patterns by un-weighted

averages that do not explain economic performance. More particularly, the subprime crisis challenges contract law, property law and enforcement law as well as accounting rules of both common law and civil law to compete institutionally for the most efficient and rapid crisis solution (Schmiegelow and Schmiegelow 2009, Chap. 4).

The more narrowly defined legal areas of institutional competition requiring particular attention in terms of transaction costs and functional roles for economic performance are:

- Corporate laws
- Financial regulation
- Contract law
- Labor market regulations
- Real estate law
- Rules of civil procedure
- The laws governing legal professions
- Court costs, lawyers' fees and other legal transaction costs
- Density of judicial structures and alternative dispute resolution
- The role of rating agencies and debtor information
- Foreign trade and foreign capital control regimes

Increasingly, the indicators defined by Sen (1999) and the United Nations Human Development Index will also be recognized by private firms and investors as part of a functional business environment. These include

- Public infrastructure
- Educational levels
- Social security
- Standards of workers protection (Deakin et al. 2013, Chap. 6)
- Health care
- Environmental protection
- Access to justice both in the broad sense of meeting the standards just mentioned, and in the sense of access to the judiciary where they can be raised as legal needs (Blankenburg 2012; Hammergren 2012; Nakajima 2012; Schmiegelow 2013, Chaps. 5, 7–12, and 14).

Although these indicators are not the immediate subject of common law or civil law, they are relevant in terms of economic location theory, wherein some of the particularly striking deficiencies of civil law countries from LOT perspective turn out to be comparative advantages. In terms of the Human Development Index published by the UNDP, the two civil law countries, Japan and France with ranks 8 and 10 respectively, score higher than the United States (rank 12) and the United Kingdom (rank 16). By extending the analysis to include some of these indicators, this book hopes to contribute to a more balanced design of future World Bank-IFC DBs, which will stimulate rather than impair institutional competition between common law and civil law in developing and transforming countries.

1.4 Analyzing Failed and Successful "Transplants" of Legal Systems

As Berkowitz et al. (2003) have rightly argued, "legal origin" alone is not a sufficient indicator of the quality of a government. As a rule, the colonial method of transplanting a legal system was no sure way to successful economic development. In the nineteenth century, the entire common law was codified to speed its diffusion in the British Empire, more particularly in India. And yet, India's present Prime Minister Manmohan Singh, one of the few professional economists among the heads of government of the world, presented a severe reckoning of India's past development failures in his address at the occasion of the 50th anniversary of India's independence in 2007. In 2006, the World Bank ranked India, the biggest common law country, 173rd out of 175 countries for contract enforcement, casting serious doubt on the consistency of broad-brush assumptions on the superiority of common law in comparison with civil law.

The paradigm of success in the history of legal transplants, if "transplant" is at all the right word, is Japan's using, after much internal debate, elements of the French and the German civil law for its own civil and commercial codes in the 1890s. In fact, the legislative process leading to the adoption of these codes is highly instructive for today's legal reforms in developing and transforming countries. It involved the initial drafting of the entire civil and commercial codes prepared by the French legal scholar Emile Gustave Boissonade de Fontarabie and the rejection of those drafts by a group of Japanese scholars favoring English jurisprudence. It included an 8-year period of reflection used for discussions among Japanese scholars and lawmakers. It took a new direction with the return of numerous Japanese scholars and students from legal studies in Germany, where they had followed the intense debate about various drafts of the German civil code, which was to enter into force only in 1900. It ended by the adoption of Japan's own civil and commercial codes in 1897 reflecting majority preferences of Japan's legal community among various functional options in each section of the codes (Schmiegelow 2006; Boucekkine et al. 2010; Kawai and Schmiegelow 2013). In today's development policy discourse, the autonomous quality of that process would be called "ownership".

China has evidently been following a similar pattern in its dialogue with Western partners on the rule of law since the early 1990s. In designing such laws as those on patent protection, contracts and, most recently, even real estate transactions, it maintains a high degree of "ownership" in taking the initiative of organizing and directing the institutional competition between common law and civil law countries (Chap. 13). The discussions are protracted and detailed. LOT political theory or civil law legal dogmatism does not seem to go very far in these discussions. Functional analysis is appreciated. Decisions are taken with strategic pragmatism (Schmiegelow and Schmiegelow 1989), ready for adjustment in subsequent phases of market development and legal reform. Today, the degree of enforcement of China's new laws is still uncertain (Dam 2006). But, then, there is a chance for

continued institutional competition between functional solutions of common law or civil law origin. As the Chinese economy and its political process evolve, demand for law grows, as evidenced by calls for the development of a legal commentary culture (Chap. 13). Japan's history of legalization and modernization will be instructive in this connection (Hirowatari 2000). Mutatis mutandis, similar situations prevail in Vietnam, Laos and Cambodia (Matsuo 2012, Chap. 9).

In countries of Eastern Europe, Russia, the Caucasian Region, and Central Asia an initial surge of enthusiasm for legal transformation assistance on the part of advisors from common law countries, especially the US, gave way to laments about delays and failures of legal reforms as well as their undermining by corruption (Black et al. 2000). Berkowitz et al. (2003) concluded that the idea of legal transplants should be abandoned as such.

The failure in the majority of cases of colonial transplants and of the American supply-push of "templates" for legal transformation in Russia and Eastern Europe in the 1990s suggests that a new method needs to be found for using common law or civil law as sources of advice for legal reforms anywhere in the world. The evidence suggests that the "transplant" method should be replaced by what we would call the "discourse method" in which donor countries engage in international legal cooperation with developing and transforming countries while the latter maintain the ownership of their own legal reforms (Stockmayer 2009, 2012, Chap. 17).

Developing countries deserve no less commitment than transforming countries. This may mean that colonial transplants become the object of reform (Chaps. 7–9 and 14–16). US advice is engaged in legal reforms in Latin American countries of the Spanish civil law tradition (Hammergren 2012, Chaps. 8, 14). So are some German political foundations. Japan has assisted Cambodia and Vietnam in drafting a new civil code replacing the colonial transplant from France, and is currently doing the same for Laos (Matsuo 2012, Chap. 9). Even in such cases, open institutional competition between common law and civil law sources may produce functional results.

The analysis of legal reforms in developing and transforming countries must extend to economic utility, social concerns and the cultural context (Knieper 2004). China's own recent efforts to complement its dynamic economic development by a full-fledged system of social security on the continental European model are one case demonstrating this legal need. Mongolia's debate, on whether or not to allow a land law to undermine the traditional nomadic land use by parcellisation and liberalization of land sales, is another (Batsukh 2012).

While the functional qualities of common law and civil law may be discussed between Western donor countries themselves, the economic, social and cultural dimensions of legal reforms in developing and transforming countries require the essential analytical contribution of scholars and policy-makers of the reforming countries concerned. Some countries may join forces in efforts at legal integration in overlapping patterns of functional integration of their region (Bakandeja wa Mpungu 2012, Chap. 16). Others may use the catalytic effect of financial crises to push their domestic agenda of legal reforms (Kawai and Schmiegelow 2013, Chap. 15). But all contributors to the Louvain project "Institutional Competition

between Common law and Civil law" share the conviction that legal reforms cannot rely on wholesale imports of foreign templates but must be the result of a domestic process of interaction of efforts to attain policy goals, readiness to adapt to social and economic change, attention to cultural patterns and commitment to implement the reforms by effective organizational and societal integration (Schmiegelow 2010).

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Part II
Testing the Economic Impact of Common Law and Civil Law in Today's Developed Countries

Chapter 2
Identifying the Effect of Institutions on Economic Growth

Frédéric Docquier

2.1 Introduction

An undeniably stylized fact of the last century is that, with a few exceptions, the poorest countries of the world did not catch up with industrialized nations in any meaningful way. Although a considerable amount of research has been devoted to the understanding of development disparities across countries, economists have not yet found out how to make poor countries rich. Still, in comparative growth studies, many renowned economists have seen the quality of institutions as a major explanation of cross-country inequality. Standard growth theories have shown that development depends on the accumulation of human capital, physical capital, and access to modern technologies. Accumulation of these factors is likely to be affected by institutional characteristics such as the organization and functioning of the productive sector, the distribution of political and civil rights, the quality of the legal system, government effectiveness, etc. However identifying a causal effect of institutions on development, quantifying its size, and understanding the technology of transmission of institutional quality to growth are challenging issues. This paper reviews the major insights of the literature, adds a few caveats, and provides a few suggestions for further research.

Let me first clarify how the concept of "institutions" has been defined in the literature. Following North (1990), "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction". Acemoglu et al. (2005) dismantled the engine and defined institutions as a combination of three interrelated concepts:

- *Economic institutions*—They include factors governing the structure of incentives in society (i.e. incentives of economic actors to invest, accumulate factors,

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make transactions, etc.) and the distribution of resources. For example, the structure of property rights, entry barriers, set of contract types for business offered in contract law, or redistributive tax-transfer schemes, are affecting economic performance and growth.

- *Political power*—Economic institutions are themselves the outcome of collective choices of the society. A society is made of different groups with conflicting interests. The relative political power of these groups governs their capacity to decide the administration of resources and implement policies. The distribution of political power determines the design and the quality of economic institutions. It results from *de facto* political power (i.e. political power emerging from economic outcomes) and *de jure* political power.
- *Political institutions*—They include institutions allocating *de jure* political power across groups. They are linked to the characteristics of the government and the design of the constitution. This raises numerous questions, which include among others: Who elects the empowered? How power distribution is structured? Where decision-making power is held?

The interactions between these three notions govern institutions, growth and development, but also the reverse causal effects of the economy on institutions. As emphasized by Acemoglu et al. (2005), political institutions and the distribution of political power in society are determined by the distribution of resources. They govern the design of economic institutions, which in turn determine the level of development and the dynamics of the distribution of resources. For example, in a very unequal society, prejudiced groups can engage in activities (exit, protest, revolt, military coup) that will change political and economic institutions. Hence, when assessing the impact of institutions on growth, a first difficulty is to disentangle the causal and reverse causal relationships between these two variables. A second problem is that many unobserved variables could simultaneously affect institutions and growth, leading to spurious correlations. A third major issue stems from the fact that the system exhibits persistence: political institutions are durable and changes in institutions translate into economic performance with a certain lag.

In the remainder of this chapter, I first explain how the three components of institutions described above have been measured in the literature (Sect. 2.2). I then illustrate the strong correlation that exists between institutional and economic development (Sect. 2.3). Finally, I review the literature on the causal impact of institutions on growth and discuss its limits (Sect. 2.4).

2.2 Measurements of Institutional Quality

Several databases have been developed to characterize the quality of institutions. I list below the main databases used to describe political power, and political and economic institutions.

On political institutions, the *Polity* project records the authority characteristics of many states in the world. The latest version, *Polity IV*, covers all major, independent states in the global system (i.e., states with total population of 500,000 or more in the most recent year; currently 164 countries) over the period 1800–2010. The *Polity IV* data set provides an index of democracy. This index combines two eleven-point scales (0–10) of democracy and autocracy. The democracy index is a variable aggregating three characteristics of institutions: first is the presence of institutions and procedures through which citizens can express effective preferences about alternative policies and leaders; second is the existence of institutionalized constraints on the exercise of power by the executive; third is the guarantee of civil liberties to all citizens in their daily lives and in acts of political participation. The autocracy index is derived from codings of the competitiveness of political participation, the regulation of participation, the openness and competitiveness of executive recruitment, and constraints on the chief executive. Other country-specific variables are provided in the *Polity IV* database, such as the occurrence of coups d'état (1946–2011), major episodes of political violence (1946–2008), size of forcibly displaced populations (1964–2008), a fragility index (1995–2011), etc. It is worth noticing that Beck et al. (2001) built another database covering 177 countries over 21 years (1975–1995). The latter database includes 108 variables describing elections, electoral rules, types of political system, party composition of the government coalition and opposition, and the extent of military influence on government.

Political power partly results from the political institutions described above (*de jure*), and from the distribution of resources across groups (*de facto*). Examples of groups of influence affecting political decisions and economic institutions are: religious groups, ethnic groups, military forces, workers' and firms' unions, diaspora members abroad, etc. Various databases can be used to document the size of these groups and the distribution of *de facto* political power. For example, Alesina et al. (2003) have collected data on the relative size of linguistic, ethnic and religious groups; they used them to construct an index of fractionalization for 215 countries and territories for the period of the late nineties. Docquier et al. (2009) have estimates of the size of the emigrant diaspora by country of destination, by education level and by gender for 195 countries in 1990 and 2000.

Many data sources can be used to document economic institutions. The main databases are the following:

- *Transparency International* produces measures of perceived corruption. Corruption is defined as the abuse of entrusted power for private gain. The CPI (Perceived Corruption Index) measures the perceived level of public sector corruption in many countries. The CPI is a composite index reflecting the views of observers from around the world, including experts living and working in the countries and territories evaluated. The recent 2012 CPI provides data for 176 countries. The first wave was issued in 1995 but for a limited number of countries (41).

- The *Governance matters* project started with the work of Kaufmann et al. (1999). The most recent methodology is described in Kaufmann et al. (2009). The database reports six broad dimensions of governance for over 200 countries over the period 1996–2011. The six dimensions will be defined in the next section. The database also relies on experts' views. The six aggregate indexes are reported in standard normal units, ranging from approximately −2.5 to 2.5.
- The *Doing Business* database provides measures of business regulations and their enforcement from 2003 to the present. Each economy is ranked according to ten sets of indexes: starting a business, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency. A composite index of "Ease of Doing Business" has been constructed and used to rank countries.
- The PRS group has produced country ratings for three types of risk (political, economic and financial risks) from 1984 to the present. Their *International Country Risk Guide* (ICRG) database now monitors 140 countries; fewer observations were available for the 1980s. A composite index of country risk combines the three components above. Compared to the previous databases, one advantage of ICRG is that longitudinal data are available on a longer horizon of about 30 years for many countries.
- *Freedom house*, a non-governmental organization, has produced comparative data on the level of democracy and freedom in all countries and dependent territories from 1972 to the present. The survey measures freedom according to two broad categories: political rights and civil liberties. The results of the survey are presented in a dataset that contains three main variables: an index of the level of political rights, an index of civil liberties, and the Freedom House Index (FHI), which is the average of the other two indices. The 2011 version includes 204 countries; fewer observations were available for earlier years.
- The Heritage Foundation has produced data on *Economic Freedom around the World* since 1995. Detailed information is provided for 185 countries on property rights, freedom from corruption, fiscal freedom, government spending, business freedom, labor freedom, monetary freedom, trade freedom, investment freedom and financial freedom.
- Andrei Shleifer has developed a cross-country database on *Legal origins*. It distinguished countries adhering to common law and legal systems based on the civil law (French, German, Scandinavian and Socialist legal origins).
- Sachs and Warner (1995) have developed data on *Openness to trade*. They judge a country to have a closed trade policy when it has at least one of the following characteristics: nontariff barriers covering 40 % or more of trade, average tariff rates of 40 % or more, a black market exchange rate that is depreciated by 20 % or more relative to the official exchange rate, a socialist economic system, a state monopoly on major exports. They document the year of openness for a large number of developed and developing economies.

2.3 Correlation with Economic Development

Measures of economic institutions are highly correlated. To illustrate this, let me focus on the six indices of governance provided in the *Governance Matters* database described in Kaufmann et al. (2009). They capture various dimensions of institutional quality:

- *Voice and accountability* captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
- *Political stability* and *absence of violence* measures perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism.
- *Government effectiveness* captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
- *Regulatory quality* captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
- *Rule of law* captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.
- *Control of corruption* captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as the "capture" of the state by elites and private interests.

First, as shown in Table 2.1, these various dimensions of governance exhibit correlation rates ranging from 0.60 to 0.95, with a mean equal to 0.85. For this reason, it is very difficult to identify the dimensions that induce the largest growth potential. Second, the correlation rates between the level of development (as measured by the log of GDP per capita) and these six indexes of governance are also very great. Figure 2.1 shows that the semi-elasticity of GDP per capita to the quality of governance varies between 0.78 and 1.06, with R-squared ranging from 0.36 to 0.65. The largest correlation rates are identified for Government Effectiveness and the Rule of Law.

Comparing the dynamics of institutional quality and development reveals a different picture. In Figs. 2.1 and 2.2, the growth rate of each variable is represented on the vertical axis and its initial level is represented on the horizontal axis. A convergence phenomenon is at work if, on average, the growth rate is a decreasing function of the initial level of the variable. In that case, countries with initially low levels of institutional quality or development tended to improve at a faster pace than countries with initially high levels. It appears that institutional quality has converged across countries in the recent past and over a longer horizon: both CPI index

Table 2.1 Correlation between governance indexes

	Voice	Stab	GEff	Reg	RoL	Corr
Voice and accountability (Voice)	1.00	0.70	0.78	0.77	0.83	0.79
Political stability (Stab)	0.70	1.00	0.69	0.60	0.77	0.75
Government effectiveness (GEff)	0.78	0.69	1.00	0.93	0.95	0.93
Regulatory quality (Reg)	0.77	0.60	0.93	1.00	0.90	0.85
Rule of Law (RoL)	0.83	0.77	0.95	0.90	1.00	0.95
Control of corruption (Corr)	0.79	0.75	0.93	0.85	0.95	1.00

Own calculations based on "Governance Matters VIII" database, Kaufmann et al. (2009)

(over the last decade) and the ICRG index of socio-economic conditions (over the last three decades) exhibit convergence. On the contrary, there is no sign of convergence in GDP per capita over the recent past or over a longer period. Hence, the dynamics of institutions differs from that of economic development. The correlation between the growth rate of GDP per capita and the growth rate of the ICRG index is lower than 0.3. This confirms that relationships between institutions and growth or development might be complex, and possibly involves long lags.

2.4 Identifying Causation

The identification of bivariate correlations between institutions and growth can be improved if one allows economic growth to be affected by other determinants or control variables. More sophisticated relationships between variables can be quantified using the powerful tools of econometrics. An empirical model assessing the link between institutions and development could be written as following:

$$\ln Y_{it} = \alpha + \beta \times Inst_{it} + \sum_k \gamma^k \times Control_{it}{}^k + \varepsilon_{it},$$

where ln Y_{it} is the log of GDP per capita in country i at period t, $Inst_{it}$ is a set of measures of institutional quality, $Control_{it}{}^k$ is a vector of k other explanatory variables, ε_{it} is the error term, and $(\alpha, \beta, \gamma^k)$ is a vector of parameters to be estimated. Variants of this model can be used (e.g. variants with a delayed influence of institutions or, in the spirit of Fig. 2.2, a "beta-convergence" model that explains the growth rate of GDP per capita on the left-hand side, ln Y_{it}/Y_{t-1}, using the same explanatory variables and the lagged level of GDP on the right-hand side).

A positive coefficient for β reflects a positive association between institutions and development. However association does not mean causation. Identifying a causation link is difficult for several reasons:

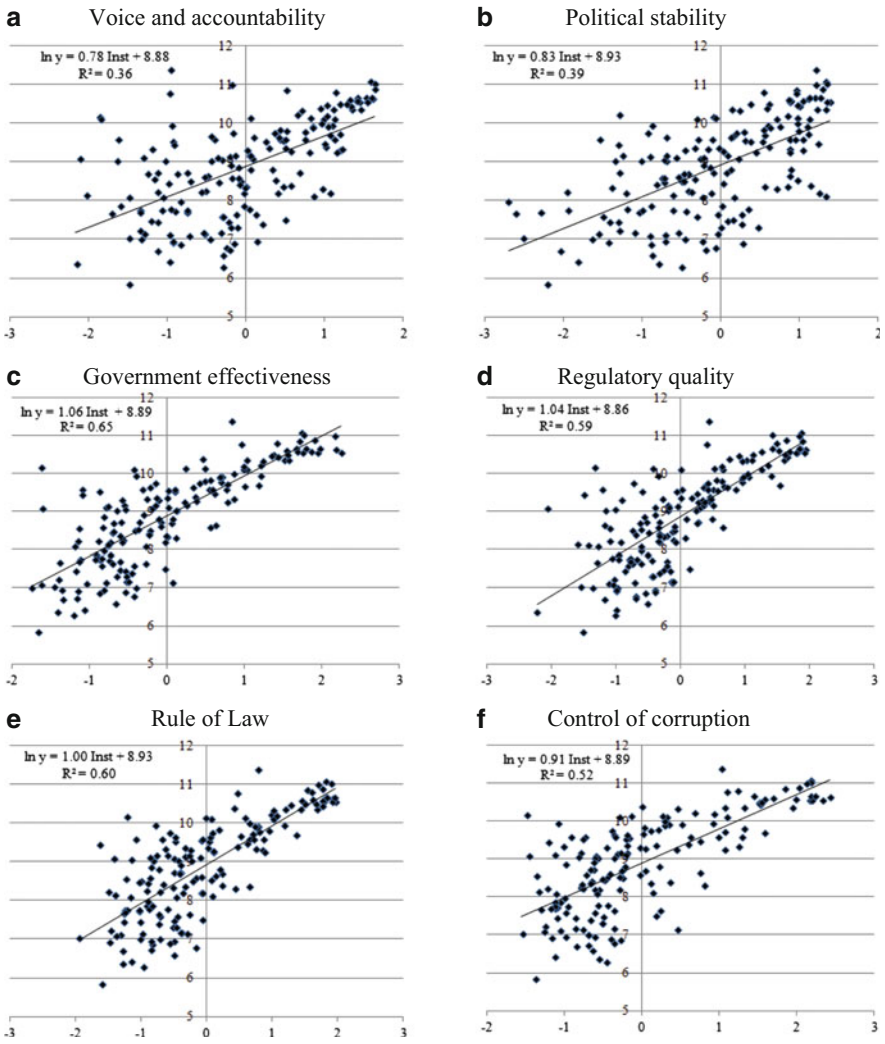

Fig. 2.1 Correlation between governance and GDP per capita (year 2011). Own calculations. *Legend*: ln y = log of GDP per capita, measured in PPP value (*Source*: World Development Indicators), Inst = governance index (*Source*: "Governance matters VIII" database, Kaufmann et al. 2009). (**a**) Voice and accountability, (**b**) political stability, (**c**) government effectiveness, (**d**) regulatory qualitye), (**e**) rule of law, (**f**) control of corruption

- First, correlation between $Inst_{it}$ and ln Y_{it} can be driven by the existence of unobserved variables Z_{it} affecting both institution quality and development. In that case, variables are spuriously correlated but causally unrelated.
- Second, correlation can be driven by a reverse causality relationship, i.e. ln Y_{it} affecting $Inst_{it}$. For example, Dawson (2003) has explored the causality relationship between political/economic freedom and growth.

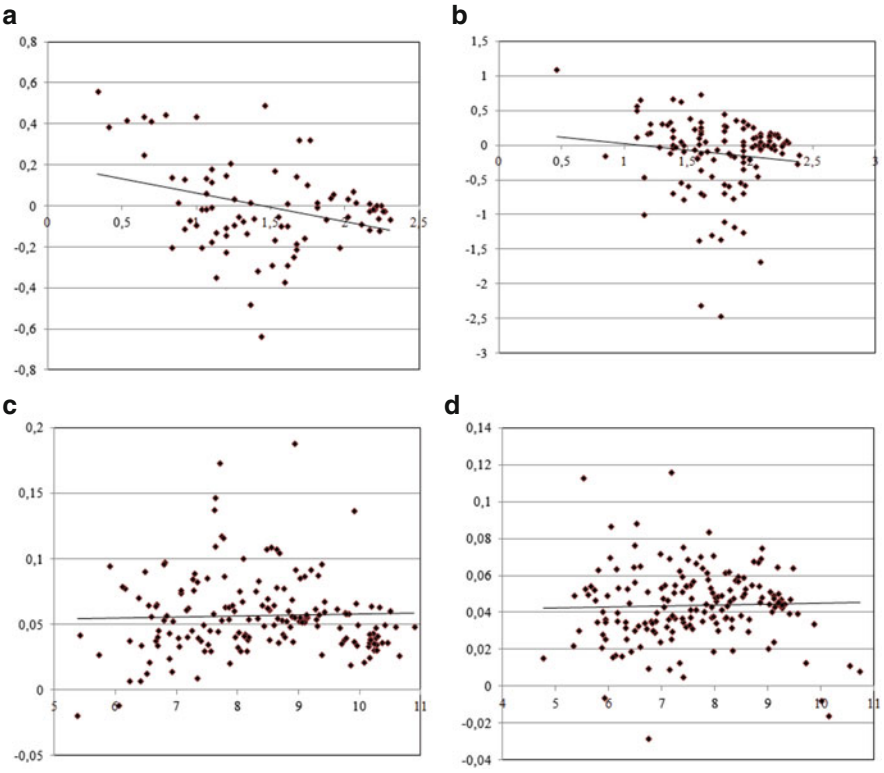

Fig. 2.2 Cross-country convergence in institutions and development.
Own calculations. *Legend*: The growth rate of the variable is represented on the vertical axis and its initial level is represented on the horizontal axis. CPI is taken from Transparency International (83 observations), Socio-economic conditions are obtained from the ICRG database (123 observations), log of GDP per capita is measured in PPP value and obtained from the World Development Indicators (174 observations). (**a**) Corruption perception index 1998–2011, (**b**) socio-economic conditions 1985–2006, (**c**) GDP per capita 1998–2011, (**d**) GDP per capita 1980–2011

- Third, identifying a relationship might be difficult if variables are subject to serious mismeasurement problems.
- Fourth, data on institutions and development are available for a limited set of countries and periods. This may induce problems of small sample size and selection (more missing observations for some groups of countries).
- Fifth, the reduced-form specification used in the regression might not reflect the actual technology of transmission of the influence of institutions on development, either because the functional form is not appropriate (Is the effect linear, convex/concave, monotonic?) or because several components of institutions must interact. In such a case, the regression suffers from a misspecification bias.

In general, solutions have been proposed to solve these problems. To capture unobserved heterogeneity, adding a large number of controls can partly solve the

problem but generates problems of collinearity between variables. If data on controls are not available or imprecise, it is common to use country and time fixed effects, i.e. imposing that unobserved characteristics can be captured with a constant for each country and a constant for each period: $Z_{it} = z_i + z_t$. The drawback is that an unobserved shock that is specific to one country and one period (e.g. election of a good or bad political leader) cannot be accounted for.

Reverse causality issues can be addressed by using Instrumental Variables (IV) regressions. The principle is to find one or several instrument(s), i.e. one or several variable(s) that do not belong to the set of controls (an instrument has no direct effect on the dependent; here, economic growth) and are correlated with the endogenous explanatory variables (here, institutional quality). The IV method consists in running a first-stage regression of the endogenous explanatory variable on the instrument(s); this first-stage purges the explanatory variable from reverse causality. Then, in the second-stage, the dependent can be regressed on the predicted or instrumented level of the explanatory variable. The IV method also corrects for mismeasurement problems and unobserved heterogeneity.

These solutions are difficult to implement in the case of institutions and growth. Finding an instrument predictive of institutions without directly impacting economic growth is a very complex task. In addition, the impossibility to account for time and country-specific shocks affecting growth and institutions (e.g. election, revolution, political reforms) is also a major problem. Finally, the absence of longitudinal data on institutional quality for a large number of countries and for a long period is another source of concern. Several studies have tried to address these issues. I review below some of the major contributions and then discuss their drawbacks.

2.4.1 Insights from the Current Literature

The most influential studies in the literature on institutions and growth address the reverse causality issue by relying on instrumental variable regressions. Based on the fact that institutions are strongly persistent, the quality of institutions is instrumented in the first stage using variables reflecting the settlement decisions of colonizers and imperial powers between the sixteenth and the nineteenth century.

Hall and Jones (1999) have studied the causes of cross-country variation in output per worker. They found that the differences in capital accumulation, productivity, and therefore output per worker are driven by differences in institutions and government policies, referred to as social infrastructure. To quantify the impact of institutions (as measured by an average of five indexes taken from the ICRG database, and by Sachs–Warner's index of openness to trade), they accounted for feedback effects from output per worker to social infrastructure. They instrumented social infrastructure with geographical and linguistic characteristics of an economy: distance from equator and the extent to which languages of Western Europe are spoken as a mother tongue. They viewed these characteristics as "measures of the

extent to which an economy is influenced by Western Europe, the first region of the world to implement broadly a social infrastructure favorable to production". They concluded that the country with the best institutions has between 25 and 38 times higher output per worker than the country with the worst institutions. Differences in social infrastructure rather than differences in factor endowments therefore account for most of the observed cross-country variations in output per worker.

Acemoglu et al. (2005) refined the Hall and Jones' study and related the quality of institutions in developing countries to the type of colonial experience. They distinguished two types of European colony. Colonized countries with a temperate climate (e.g. North America, Australia, etc.) were suitable for agriculture and settlement. Colonial powers put in place *institutions of settlement*, which are very similar to those in their home countries. In contrast, countries with adverse climatic conditions and rampant diseases were seen mainly as sources of rent. Colonial powers put in place *institutions of extraction*, which were designed to facilitate extraction of resources and their transfer to the imperial power. The latter give much less importance to property rights, political and economic freedom. After the end of the colonial era, these institutions proved to be persistent: colonial powers were replaced by homegrown dictators who continued to use the extractive institutions for their personal benefit. Hence, in their IV regressions, Acemoglu et al. (2005) used data on mortality of European settlers, soldiers and missionaries to predict the quality of institutions in developing countries. In the first stage, they found a strong negative correlation between Europeans' mortality and quality of institutions. When using institutions instrumented by the mortality figures to explain differences in per-capita incomes across countries, they found that institutions account for up to three quarters of the variation in incomes across countries.

Another strand of literature, summarized by La Porta et al. (2008), goes under the name of Legal Origins Theory (LOT). This literature finds significant evidence that different socio-economic outcomes can be traced back to fundamental differences in legal traditions, the crucial divide involving the opposition between common law and civil law (with the former proving more conducive to economic success). It picks up the thread of older comparative law theories, by considering English, French, German, Scandinavian and Socialist "legal origins" as determinants of distinctively different levels of quality of government and economic performance. More precisely, it begins with the important question of why the stock markets of London and New York were so much larger and dynamic in the 1990s than those of Paris and Frankfurt. The key proposition is to link the level of financial development to the existence and strength of legal rules providing investor protection (La Porta et al. 1997, 1998). From this starting point, the proponents of LOT have made several seminal empirical contributions to the interdisciplinary research on comparative development:

- First, they argue that the quality of the legal rules can be measured and quantified for an important group of countries, using national commercial laws as a proxy for the strength of investor protection.

- Second, they posit that the legal rules protecting investors vary along legal traditions, with common law systems being more protective of outside investors than civil law systems.
- Third, in line with their initial proposition, they show empirically, in a cross-section of countries, that the level of legal investor protection is indeed a strong predictor of financial and economic development. In order to avoid the objection of reverse causality (i.e. countries improve their laws as their financial markets develop), "legal origin" is used as an instrument for legal rules in a two-stage regression procedure, where the second stage explains financial development. Their key argument is that legal traditions were introduced through conquest and colonization, and were hence largely exogenous to the current level of financial development.

Further studies have examined the influence of legal traditions on some other spheres of economic activity. Civil law is systematically associated with a greater influence of government ownership and regulation than common law, which is empirically identified as leading to undesirable market outcomes, such as greater corruption, larger unofficial economy and higher unemployment levels (La Porta et al. 2002; Djankov et al. 2002; Botero et al. 2004; also La Porta et al. 2008 for a comprehensive review). To summarize, LOT's most influential thesis is that common law favors the trust of uninformed capital owners among professional insiders acting as agents in the best interest of their principals, as opposed to the case for civil law (common law countries are perceived as more protective of private property than civil law countries). This claim is justified on religious, sociological and political grounds.

2.4.2 Discussion and Caveats

The goal of Hall and Jones (1999) and Acemoglu et al. (2005) was to quantify the causal impact of institutions on growth. The choice of instrumental variables is always a matter of concern. Instruments are assumed not to have a direct effect on the dependent variable. They use geographical characteristics, eighteenth century mortality rates, and linguistic characteristics. Are they good instruments?

Although debated in the literature, the theories developed by Ashraf and Galor (2013) and Diamond (1997) see geographical locations and disease as the main determinants of economic performance before the industrial revolution. In the Ashraf-Galor's theory, the channel of transmission is the level of genetic diversity in the population (which varies with distance from Africa), whereas Jared Diamond's theory emphasizes the role of biodiversity (which mainly varies with latitude). Other studies have shown that geographical characteristics impact diseases and productivity, although the native populations have developed (partial) immunity to tropical diseases. Acemoglu et al. (2005) argue that mortality of Europeans is a valid instrument and not a proxy for climate and geography because

tropical countries were often among the richest countries prior to colonization (e.g. the Moghul Empire in India, Aztecs in Mexico and Incas in Peru). As far as linguistic characteristics are concerned, they might affect human and physical capital accumulation through emigration rates or information/transaction costs between countries. For example, Docquier et al. (2009) have shown that brain drain rates are larger in English speaking countries, and that many countries are losing more than 50 % of their "brains".

Ultimately economic factors in the colonial era impacted colonizers' decisions and are likely to be very persistent. To illustrate this, I use Maddison's data on GDP per capita in the years 1820 and 2000. The level in 1820 is used as a proxy for the level of development before the colonial expansion. As shown in Fig. 2.3, regressing the log of GDP in 2000 on the log of GDP in 1820 shows that the development level in the eighteenth century is an excellent predictor of the current development level in both industrialized countries (data available for 20 industrialized countries are represented in grey) and developing countries (data available for 42 developing countries are represented in black). This is confirmed by econometric studies. Bockstette et al. (2002) showed that population growth (a good proxy for economic development during the Malthusian epoch, and institutional quality in antiquity) are excellent predictors of income per capita and economic growth in the recent decades. From this, it might be argued that the type of institution implemented by imperial powers was statistically linked to unobserved factors affecting long-term economic performance. The quantitative assessment of the development impact of institutions must be taken with caution.

The LOT approach argues that fundamental differences in legal traditions explain cross-country differences in development. The "legal origin" variable is used in the first-stage as a predictor of key determinants of financial development. While fully recognizing the merits and the methodological rigor of the LOT approach, I also believe that the effect is less clear due to misspecification and mismeasurement problems:

- The simple divide based on legal origin—although meaningful—neglects conceptual aspects such as the difference between law and regulations, and does not take into account the cost of "access to justice". Any growth-enhancing legal system will prove to be useless if people cannot access justice. In other words, legal origin may matter, but only if the rules are actually enforced. This is in line with Acemoglu et al. (2005) who see the decision to implement *institutions of settlement* or *institutions of extraction* as endogenous.
- The legal origin variable hides important differences cutting across the common law/civil law divide (Schmiegelow 2009), the most striking being US reliance on legislated regulation of financial markets (associated by LOT with civil law legal process) as against the English tradition of judge-made law (Dam 2006). Also there are problems in coding countries clearly as common law or civil law. For example, LOT codes most Latin American countries as part of French legal origin, although they have become hybrid legal systems as a consequence of far-reaching English and American influence (Dam 2006). Although Thailand

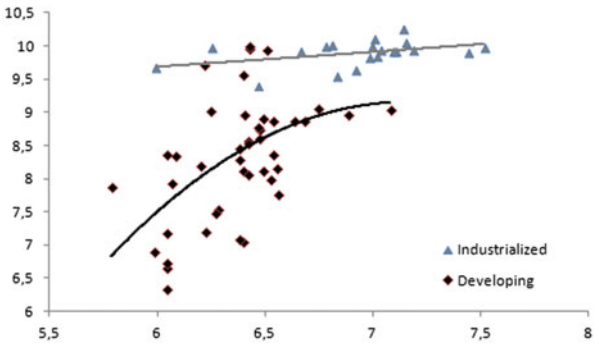

Fig. 2.3 Log of GDP per capita in 1820 (X axis) and in 2000 (Y axis). Own calculations based on historical data on GDP per capita from Maddison (2007)

and the Philippines have mixed legal origin systems (Kawai and Schmiegelow 2013 and Chap. 15), the Philippines is classified as a civil law country and Thailand is classified as a common law country.

- LOT's empirical contribution is essentially based on a static cross-country analysis, which cannot fully exploit the effects of legal changes inside given countries.

These limitations may also explain why existing studies generally fail to find a clear, reduced-form effect of legal origins on aggregate growth (La Porta et al. 2008, p. 302). To illustrate this, regressing the current log of GDP per capita to its level in 1820 and with two dummy variables for civil law and common law, I obtain a non significant effect for the legal origin variable at the 10 % level (a star indicates a significant effect at the 1 % level):

$$\ln Y_{i,2000} = -7.0^{*} + 2.4^{*}\ln Y_{i,1820} + 0.10Com - 0.02Civ \quad (103\,obs)$$
$$\ln Y_{i,2000} = -7.0^{*} + 2.4^{*}\ln Y_{i,1820} + 0.30Com + 0.30Civ \quad (75\,obs)$$

These results hold true for the sample of 103 rich and poor countries (first equation), or for the sample of 75 developing countries (second equation). Again, quantitative predictions of the influence of legal systems must be taken with caution.

2.5 Conclusion

What are the recommendations for future research? Institutional inertia is strong, any institutional changes in quality and any effects on development are likely to operate slowly. Instead of comparing a large number of countries on a cross-country basis, it might be interesting to focus on a smaller sample of countries and collect long-term data on institutional and economic changes. For example, to overcome the "static" limitations of existing LOT studies, Balas et al. (2009) built an index of procedural formalism for every year since 1950, for a sample of 40 countries. They

found evidence that national legal systems are not converging. However, they did not relate the degree of procedural formalism to economic outcomes. A historical analysis was also conducted by Boucekkine et al. (2010), and Chap. 3 of this book. We selected countries that have experienced institutional changes at different periods. Then we tested for discontinuities in their growth trajectories related to institutional changes. Our sample includes eight countries, which can be seen as mother countries of legal origins, financial centers or newly industrialized economies (France, Germany, Japan, South Korea, Switzerland, Taiwan, the UK and the US) over a very long period (1870–2008). As far as institutions are concerned, we focus on how default rules are legally treated and codified for ten economically important contract types. The economic impact of default rules on economic growth was detectable by econometric panel analysis and proved to be strong. Although we controlled for time/country fixed effects and imposed a lag structure in the spirit of Granger (current GDP growth is affected by lagged codified rules), our analysis is admittedly subject to an endogeneity issue: there might be unobserved time-varying characteristics affecting default rule codification and growth simultaneously. However, our results dismantle and temper the LOT theory by illustrating the role of contract theory in economic institutions. Obviously, extending this analysis to developing countries having received their laws as colonial transplants would require accounting for the way codified default rules are implemented and enforced. Part II of this volume begins addressing this task with chapters on access to justice in selected developing countries.

Are there alternative and better methods to capture causation? Randomized controlled trials (RCT) are increasingly used in economics to identify causal relationship and compare the effectiveness of alternative policies. In line with clinical experimentation, the principle is to randomly select subjects from a population and submit them to a treatment; other subjects will not be treated (control group). If the treatment and control groups were randomly selected ex-ante, their post-treatment difference can be attributed to a causal impact of the treatment. In these studies, the randomization stage is important. And RCT are usually conducted on small groups; this raises the issue of their external validity.

It is obviously too costly and too difficult to conduct RCT at the level of a country, or in several countries. For this reason, economists have been increasingly searching for natural experiments, i.e. comparing the dynamics of two groups, which were initially similar and experienced different natural unexpected shock. In this case, the assignment occurs naturally, without the researcher's intervention. For example, Acemoglu et al. (2005) see the separation between Communist North Korea and private-market South Korea in 1945 as a natural experiment (the 38th parallel experiment). Both countries were fairly identical in economic characteristics and performance before 1945. Today, South Korea is more than ten times richer than North Korea. They see the ex-post difference in their economic trajectories as resulting from the impact of institutions. Boucekkine et al. (2010) and Chap. 3 refer to the systematic difference between how centralized planned economies such as North Korea or the former GDR and market economies such as South Korea and West Germany before 1989 coped with the problem of offering complete

contingent solutions for any unforeseen future state of affairs. The former needed to elaborate a new plan or new single centralized command; the latter could rely on the principle of private autonomy of market participants for concluding contracts, with contract law default rules easing business by reducing transaction costs, rebalancing information asymmetries and solving the problem of incomplete contracts in a decentralized manner. However, we recognize that, in the Korean case, it is difficult to disentangle the part concerning the development gap, which is attributed to economic institutions and legal differences, from that due to the political support and assistance North Korea received from China and the Soviet Union, and South Korea from advanced democracies. Searching for other quasi-natural experiments might be useful to understand the causal effect of institutions on growth.

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Chapter 3
Contract Rules in Codes and Statutes: Easing Business Across the Cleavages of Legal Origins

Raouf Boucekkine, Frédéric Docquier, Fabien Ngendakuriyo, Henrik Schmiegelow, and Michèle Schmiegelow

3.1 Introduction

Legal origins theory (LOT) is intellectually related to Andrei Shleifer's and Robert Vishny's influential 1997 paper refuting the efficient market paradigm in finance (Shleifer and Vishny 1997). Their research in behavioral finance led them to the conclusion that markets do not automatically eliminate price distortions thanks to an assumed presence of countless arbitrageurs. They found that only a limited number of professional insiders with access to ample and patient capital are able to prevail against masses of inefficient "noise traders" by contrarian strategies over extended periods of time. Hence, LOT focuses quite naturally on behavioral patterns and legal rules encouraging the provision of capital to financial markets (La Porta et al. 1997, 1998). LOT's most influential thesis is that common law

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encourages uninformed capital owners to trust professional insiders acting as agents in the best interest of their principals.

The question is whether it can assume as boldly as it does, that common law is economically superior to civil law (La Porta et al. 1999, 2008). Initially, the assumption was based on both religious sociology and political theory: Robert Putnam's research on Catholic distrust of strangers, which LOT assumed to be manifest in civil law, and LOT's own political theory that civil law, since Roman times, has been the expression of the will of the ruler (La Porta et al. 1999). The weakness of the sociological argument was immediately evident in the cases of the civil law of the Protestant Netherlands, the common law of Catholic Ireland and the status of the bi-confessional civil law country Switzerland as a financial center. Hence the argument is no longer maintained in LOT's major restatement of 2008 (La Porta et al. 2008). The restatement maintains, however, its political theory of civil law, failing to recognize that the interpretation of Roman law as a product of imperial rule was already rejected by Friedrich von Hayek in 1973, a great admirer of the common law frequently cited by LOT as an authority (Mahoney 2000; La Porta et al. 2008). Hayek emphasized that classical Roman law has deeply influenced all Western law including English common law and that the Justinian code was a digest of Roman jurisprudence beginning in the Roman republic in a legal process very similar to the later English common law (von Hayek 1973, at 83).

And yet, there is unmistakable merit in LOT's major effort to attempt an econometric measure of the importance of law in economics. If the efficient market paradigm does not capture real economic development, as argued by Shleifer and Vishny, something else must account for it and as the institutional economics of both the older German "ordoliberal" tradition (Böhm 1966; Streit 1992) and of the newer Coasian (Coase 1988) and Northian (North 1990) departures agree, the law plays a crucial role as a framework allowing free markets to function. Whereas LOT has particular strengths in law and finance, it is much less concerned with contract law, the bedrock of day-to-day economic transactions. Although it does consider strong rules of contract enforcement as an important indicator of the comparative quality of legal origins, it does not seem to be interested in how the law can ease the conclusion of enforceable contracts. Except for relationship-specific contracts in corporate law, LOT appears to bypass contract theory. In classical contract theory, a complete contract fully specifies the rights and duties of the parties to the contract for all possible future states of the world. Indeed, this notion reflects the classic common law requirement of complete consent between the contracting parties about every right and obligation that may become the object of litigation. However, since Williamson (1975) recognized that it is either impossible or inefficient in terms of transaction costs to write complete contingent contracts, economists and legal scholars have sought solutions for both the countless case-by-case contracts prevailing in daily business life as well as for the relationship-specific contracts consolidated in corporate law (Grossman and Hart 1986; or Hart and Moore 1988, in the economic literature, and Barnett 1992; Farnsworth 2008, in the law literature).

While economists have analyzed the transaction cost and incentive effects of the problem, American legal scholars have focused on how default rules provided by the law fill the gaps of incomplete contracts (Barnett 1992; Farnsworth 2008). Legal theory distinguishes between discretionary and mandatory rules. Discretionary rules can be abrogated or modified by the contracting parties. Mandatory rules will be enforced, even if the parties attempt to override or modify them. Codified default rules are either discretionary or mandatory. Most default rules of economically important contract types codified in civil law countries are discretionary, since all civil codes in the Roman tradition rely on the principle of "private autonomy" (Zimmermann 1990). But all contract types of the major civil codes are also subject to some mandatory rules, the most important of which is the general clause of "good faith". Some codified contract types rely entirely or preponderantly on mandatory rules. This is the case of German and Swiss *Versicherungsvertragsgesetze* (Insurance Contract Laws) of 1908, the Chinese Insurance Law of 1929, in force in Taiwan since 1950, and the French *Loi sur le contrat d'assurance* (Insurance Contract Law) of 1930 (Reichert-Facilides 1998).

Civil and commercial codes of civil law countries provide default rules for most of the economically important types of contracts (sales, lease, employment, services, construction, insurance, loans, guarantee, etc.). In common law countries, codified default rules are an exception, the most important being the codifying statutes for the sale of goods and services (the UK Sales of Goods Act and Art 2 of the US Uniform Commercial Codes (UCC) as well as Art 4 UCC for bank loans and Art 2A UCC for leases). Common law judges normally recognize only the clear text of the contract. Moreover, they demand proof of complete consent on any right or obligation claimed by any party in subsequent litigation. If the text of contract is unclear or incomplete in the sense of contract theory, rights and obligations of the parties will be correspondingly incomplete. As a rule, the contract is judged invalid for lack of clarity. Only rarely have common law judges attempted to save an incomplete contract from uncertainty by looking for rules "implied in the law", which might serve as "implied terms" of the contract (see Farnsworth 2008).

We submit that this marked difference of contract law between the two legal families implies a major qualification of LOT's assumption that the common law is economically superior to civil law. Even if we concede that common law provides a superior environment to financial markets by favoring a more ample flow of capital to professional insiders bound by fiduciary duties, civil law may score well by offering a safe and easy framework for the conclusion of enforceable contracts in the real economy. The provision of default rules for all economically important types of contract by civil codes as a public good offers two crucial economic advantages in addition to solving the problem of incomplete contracts. The first is that codified default rules are publicly accessible to everyone and thereby avoid the information asymmetries regularly resulting in common law countries from one contracting party writing a multi-page contract striving for "completeness" with the other party resigned to accept it. The second is that, as a public good, codified default rules spare contracting parties the transaction cost of attempting to write contracts as complete as possible even in routine cases. This may have been a

necessary, if certainly not a sufficient (Schmiegelow 2006), condition for civil law countries of German legal origin outperforming, by LOT's own admission, common law countries between 1960 and 2000 (Mahoney 2000; La Porta et al. 2008, p. 26).

In this chapter, we aim to detect the impact of defaults rules on doing business, and hence on economic performance. To this end, we take three steps:

- First, we extend the array of indicators of economic analysis of law to ten of the economically most important contract types, including purchasing equipment, hiring employees or taking a bank loan (see next section for the exhaustive list). As just these three types of contracts suggest, our indicators cover the most crucial aspects of economic decision-making, including capital accumulation, employment and bank finance of business.
- Second, we consider eight countries with landmark codifications of contract law. At the same time, these countries are paradigm countries as mother countries of legal origins according to LOT, financial centers or newly industrialized economies (France, Germany, Japan, South Korea, Switzerland, Taiwan, the United Kingdom and the United States). We inquire which of these countries have been providing default rules for the selected contract types, since when, and with what economic effect.
- Third, we attempt to attain a compensating degree of robustness for our much smaller sample of countries by using a longer time series, beginning with the movement toward contract law codification in the nineteenth century, a more focused reliance on contract theory, comparative law, legal and economic history, as well as more advanced econometric methods, than LOT.

3.1.1 Recalling the Importance of Contract Law Codification in Economic Development

Commercial contracts are the most basic and most pervasive transactions in market economies. There is no business transaction without a contract. Contract law is therefore the central and crucial legal framework for free markets. Both English common law and civil law provided such a framework for autonomous economic agents long before democracy was established, if democracy is understood according to Samuel Huntington's criteria of active voting rights for more than 50 % of the male population. This standard was not reached before 1828 in the US, 1871 in Germany, 1875 in France, 1884 in England and 1925 in Japan (Huntington 1992; Schmiegelow 1997, with detailed references). Franz Böhm, the German ordoliberal, spoke of the existence of a "Privatrechtsgesellschaft" (a society governed by private law) preceding the French revolution, most notably the contract rules of Roman law (Böhm 1966). In Europe's mediaeval legal order, they functioned as a subsystem in all areas not governed by feudal and corporative prerogatives, The major institutional change of the national codifications of the

nineteenth century was to remove feudal and corporative restrictions on economic transactions definitively and to make a universal principle of the private autonomy to conclude contracts governed by private law. As we shall explain, this institutional change has been extraordinarily stable through war and peace, business cycles, and forms of government. The *Code Napoléon* and the *Code Commercial* outlived six political régimes (Napoléon's *empire*, restoration of the monarchy, *Seconde République*, *Second Empire*, *Troisième* and *Quatrième Républiques*). The *Allgemeines Deutsches Handelsgesetzbuch* (ADHGB), the Common Commercial Code of the German Federation of 1861, was a code common to otherwise independent states in a fractured German speaking landscape in central Europe and its essential components still live on in Austria's commercial code today. In Germany, the *Bürgerliches Gesetzbuch* (Civil Code of 1896) and the *Handelsgesetzbuch* (Commercial Code) of 1897 survived the Second German Reich of 1871, the Weimar Republic, the Third Reich, and the West German Federal Republic before being extended again to East Germany following Germany's reunification in 1990. Hence, there is no risk of endogeneity bias in measuring the economic effects of the codification of contract law as may exist in the case of laws and regulations issued by legislators or governments in the pursuit of short term policy goals (Bertrand et al. 2004).

3.1.2 *Focusing on Paradigm Countries with Landmark Codifications of Contract Law*

To exclude the "transplant effect" resulting from the imposition of culturally foreign laws by colonial rule (Berkowitz et al. 2003), our sample of countries does not include the former British, French, Portuguese and Spanish colonies, which form the bulk of the 152 countries, on which number LOT's robustness tests rely. In order to avoid the "bias of the missing variable" and isolate more cleanly than LOT the comparative economic effect of common law and civil law, we have consciously chosen countries with remarkably similar and converging industrial development over the past 140 years. Except for the leadership of the US in information technology since the 1990s, which we recognize separately, all countries of our sample, whether leaders, followers or leapfrogging developers, share the major cycles of technological innovation. Except for the US, all the countries of our sample are resource-poor, which removes the problematic variable of resource endowment from our sample. One missing variable we do recognize is access to justice. The best laws will have limited economic effect, if the cost and time required for obtaining judicial relief is prohibitive for too many market participants. Hence, access to justice is a further area of research for the authors of this chapter. We assume that in most of the developing and transforming countries, access to justice is still a massive problem, which is one more reason,

in addition to the transplant effect, to exclude them from the arguments of this chapter, but to examine it in the next Part II of this book.

3.1.3 Attaining Robustness for Small Sample Through a Long Time Series

We believe that much more valuable policy recommendations can be derived from the analysis of a limited number of paradigm cases with an advanced and solid methodology than from a survey of all countries in the world with numerous caveats obscuring the merit of big samples. We identify the economic impact of the default rules provided by codified contract types as seen in per capita GDP growth. We use econometric analysis combining the most advanced tools in panel data analysis and counterfactual simulation as well as more standard techniques. In contrast to the few recent decades of the cross country analysis adopted for LOT validation, we consider prolonged periods selected for their relevance in codification history as well as for the availability of data widely recognized as reliable (1870–2008).

We assume that for econometric comparisons between common law and codified law to be more convincing than LOT's, they will, in principle, have to run regressions of chosen indicators by per capita income or growth data covering the entire period in which codes or codifying statutes of relevant countries have been in force. This will enable us to capture the impact of the entry into force of the most relevant leading modern civil codes, commercial codes or codifying statutes of the nineteenth and twentieth century in Europe, Asia and the US. We have found no easily accessible data for the period between 1804, the entry into force of the *Code Napoléon* in France, and 1870. But, beginning in 1870, our data will pick up the effect of the Code Napoléon and the *Code Commercial* of 1807 in the last decade of the *Second Empire* (1852–1870) as well as of the Common Commercial Code of the German Federation of 1861 (ADHGB).

After the required robustness checks, we find that the presence of default rules in the contract types selected do favor economic performance. The short-run effect of codifying one additional contract type with default rules on GDP is slightly lower than 0.38 %. The long-run effect on the GDP level is 13.3 %. Codifying ten contract types with default rules, which constitutes a huge institutional change, multiplies GDP per capita by almost three in the long run with a short-run effect of 3.8 %. Given the fundamental importance of commercial contracts and hence of contract law in free markets discussed above in Sect. 3.1.1, the magnitude of this effect should not come as a surprise. Because civil law codes offer such rules more systematically than codifying statutes in common law countries, there should be evidence of economic performance of at least some of the civil law countries of our sample converging with, if not superior to, common law countries for at least some periods of our long time series. And indeed, we find that the per capita GDP of not

only Germany and Japan, as already conceded by LOT, but also of France, on whose "legal origin" and state-centered political economy much of LOT rests, began exceeding that of the UK between the mid 1960s and the mid 1980s although they did not enjoy the advantages of a major financial center. We note that Switzerland with its financial center already outperformed the UK in the two decades before World War II and in all six decades thereafter, as well as outperforming the US between the mid 1950s and the mid 1980s. After their own independent adoption of civil codes in the 1950s, South Korea and Taiwan both emerged on a distinctive path of convergence as "newly industrialized economies". The one remaining Asian economy of socialist legal origin, North Korea, provides telling data for a counterfactual simulation of what the South Korean and Taiwanese GDP levels would have been without codified default rules in contract law. Hence the conclusion appears warranted that LOT's claim on the superiority of common law requires qualification.

Details of the list of contracts and short reviews of their codification as well as of the legal and economic histories of the countries selected for the study are presented in Sect. 3.2. Section 3.3 displays the main elements of our econometric set-up and presents the principal findings. Section 3.4 concludes our argument on convergences and differences between common law and civil law in the field on contract rules.

3.2 Codified Contract Rules in the Legal and Economic Histories of Selected Countries

3.2.1 Selection of Contract Types Important for Business

We posit that the most relevant contract types economically are the following ten:

1. Renting office space
2. Contracting for the construction of a building
3. Purchasing equipment
4. Insuring equipment
5. Hiring employees
6. Taking up a bank loan
7. Subcontracting work
8. Contracting with a Commercial Agent
9. Obtaining advice from a Consultant
10. Guaranteeing an undertaking by a Subsidiary

The list captures the most basic aspects of doing business. While primarily designed to qualify LOT, it may also help improve the methodology of the yearly "Doing Business" Reports of the World Bank (DB), which began in 2000 (World Bank-IFC 2000, and most recently 2013), but were found methodologically

defective by the World Bank Group's own Independent Evaluation Group in 2008 (World Bank-IEG 2008; Elliott 2009). Compared to the DB, which among all economically important contract types only considers hiring workers as a relevant concern for business and, hence, offers an "employing workers indicator" (EWI), we submit nine additional indicators. Moreover, while DB considers labor contract rules exclusively as a cost, we shall take the opposite approach of considering the presence of default rules in labor law as in all other nine-contract types as a business environment, which saves transaction costs.

3.2.2 Selection of the Sample of Countries

One of the most obvious weaknesses of LOT is its summary attribution of French legal origins to the vast majority of former colonies, even former Spanish and Portuguese colonies, with below average per capita income in Africa, Asia and Latin America (see La Porta et al. 2008). Its list of Commonwealth countries is only about half as long, which results in a much more favorable mean for the English legal origin. Obviously, with no former colonies, the German legal origin comes out on top even in LOT's own regressions. (South Korea and Taiwan were Japanese colonies until the end of World War II, but adopted their own civil codes independently after gaining their independence.) The attribution of nearly all of Latin America to the French legal origin is already questionable from a comparative law point of view (Dam 2006). Moreover, while appearing to support LOT's political theory of a state-oriented French legal system by decreasing the average results of the French legal origin, the attribution comes at the price of a major inconsistency of LOT in the case of the short list of the German legal origin. Although in LOT's view (La Porta et al. 1999), the latter shares the dysfunctional political economy of the French legal system, it benefits from LOT's inexorable mean to the extent of outperforming common law countries, thanks to the simple absence of former colonies on its list (Schmiegelow 2006). Berkowitz et al. (2003) have offered what remains, so far, the most cogent explanation of this inconsistency: LOT misses the "transplant effect" of the imposition of culturally foreign laws by colonial rule resulting, in general, in lower economic performance.

We have therefore resolved to restrict our comparison to the following paradigm categories of countries:

1. Countries considered by LOT as mother countries of the English, French and German "legal origin" (UK-England, France, Germany).
2. The US, as it is closely associated with England by LOT as a quasi mother country of common law, although it does have a written constitution and is much closer in many respects to civil law countries given the high and growing number of codifying statutes (Dam 2006).
3. Japan—which is considered by LOT to be of German legal origin, but is in fact the paradigm case of a non-Western country participating autonomously in the

nineteenth century codification movement—became the "legal origin" of the civil code of its former Korean colony as well as the country of inspiration of South Korea's autonomously adopted code of 1958 and hence must join the list of mother countries of legal origin.
4. High growth countries having voluntarily and autonomously chosen to adopt civil codes in the 1950s as purposefully designed amalgams of domestic legal traditions and borrowed Western patterns (South Korea, Taiwan).
5. Switzerland as a civil law country with a balanced economic structure having in addition developed as a major financial center, a status considered by LOT to be reserved for countries of English legal origin as a result of the superior quality of common law.

With this selection, we capture the profiles of the largest economy of the world (US), the two countries that have been the second and third largest economies after the US between 1960 and 2008 (Germany and Japan), two so-called "Asian Tigers" which have been attracting the attention of economic analysts as "Newly Industrialized Countries" anticipating over a period of four decades the pattern of China's recent extraordinary growth (South Korea and Taiwan, see World Bank 1993; Fu 2010) and the one major continental European financial center which, according to Roe (2006), owes its status to the fact that it is the only European civil law country never to have suffered a foreign occupation with the collateral effect of destroying the confidence of domestic investors (Switzerland). With Germany, South Korea and Taiwan, our sample includes three instructive cases of countries divided by the Cold War, with the civil law "Western half" spectacularly outperforming the "Eastern" half of "socialist legal origin".

The two countries that remain divided as a legacy of the cold war, China and Korea, offer particularly inviting "test cases" for measuring the economic advantages not only of a free market economy as opposed to a planned economy, but also of contract law with default rules easing business by reducing transaction costs, rebalancing information asymmetries and solving the problem of incomplete contracts. Just like private contracts in free markets with no legal institutions, no socialist planning can offer complete contingent solutions for any possible future state of affairs. In both cases, remedies can only be sought "ex post", once the problem of incomplete contracts has arisen: in hypothetical free market anarchies through new contracts or by enforcement with private force, and in still empirically observable planned economies by the elaboration of a new plan and the issuance of single new ruling party decrees. Like all legislation in countries governed by the rule of law, codified default rules offer the crucial advantage of solving the problem of incomplete contracts "ex ante" at all times and for all market participants alike, before the latter even decides to conclude a contract or to set up a new business.

To illustrate the impact of codified default rules on economic performance, we will include a counterfactual simulation of South Korean and Taiwanese GDP levels without default rules. The data of the "Eastern"—geographically Northern—half of one of the two divided Asian countries provides a useful pattern for such a simulation. We have chosen North Korea since the People's Republic of

Korea, established by Kim Il Sung in 1948, is the only East Asian country categorized by LOT as of socialist legal origin, while Mainland China is recognized as a country in the process of legal transformation towards a market economy (La Porta et al. 2008).

Except for this robustness check on North Korea, we have chosen to omit LOT's "socialist legal origin", as most former socialist countries are now transforming countries. Since their legal transformation began only in the 1990s (except for China's earlier Economic Contract Law of 1981), we consider the time period of their new contract laws and their economic development as too short a time series to pass robustness tests. To further sharpen our arguments on the common law/civil law divide assumed by LOT, we have also left out the "Scandinavian legal origin" which LOT characterizes as a "hybrid" legal system.

It might seem tempting to include other civil law countries which have independently joined the late nineteenth century/early twentieth century codification movement such as Austro-Hungary (1811), The Ottoman Empire (1850), Russia followed by the Soviet Union (1923) and China (1911/1929–1933). But all four were empires, which lost their civil law unity to nationalist separatism, shifts from one legal origin to another or to socialist revolution. In these processes, seven former Austro-Hungarian entities (Hungary, today's Czech Republic, Slovakia, Slovenia, Croatia, and parts of today's Poland), 20 formerly Ottoman entities (including Moldavia, Romania, Bosnia, Serbia, Montenegro, Albania, Macedonia, Bulgaria, and Armenia) and 16 former Soviet-Russian entities (Russia, Estonia, Latvia, Lithuania, parts of today's Poland, Ukraine, Moldavia, today's Central Asian and South Caucasian countries) became independent. Meanwhile China was de facto divided into Mainland China and Taiwan.

The seven former Austro-Hungarian countries retained their Austrian code of 1811 between the two world wars, and became part of the socialist legal origin after World War II and are now transforming countries, which preclude their inclusion in our sample. Some of the 20 former Ottoman entities retained the Ottoman code of 1850, which was a blending of elements of the code Napoléon and Islamic traditions, while Kemalist Turkey joined the German legal origin with a new civil code in 1926 (Tuncay 2007). All European entities of the Ottoman Empire moved to socialist legal origin in the postwar period and are now transforming countries, while some of the Middle Eastern entities emerged in the interwar and postwar periods as the world's major oil producing countries, which again makes them unfit for our sample. The drafting of the first Russian civil code was not completed before the October Revolution in 1917. Counter-intuitively, it was left to the Soviet Union to complete the draft and promulgate it in 1923. The "Soviet civil code" was, however, only a transitory departure from socialist legal régime change during the first three and a half years since the October Revolution. It was a legal expression of Lenin's "New Economic Policy" (NEP), which promoted private contracts, but, in turn, was ended by Stalin in 1928 with the collectivizing of agriculture and the expropriation of all industrial means of production (Kantorovitch 1923). From 1928 to the end of the Soviet Union in 1991, the former Soviet republics constituted the core of the socialist legal origin, and since then, the bulk of transforming countries.

The Chinese empire became a divided country with the victory of Mao's revolution on the mainland in 1949 leaving Taiwan to apply the Chinese code of 1929–1933 and emerge as one of our paradigm cases of resource-poor newly industrialized countries as described in Sect. 3.2.3.

Except for Austria, which would fit our criteria of resource-poor countries owing their industrial development to outstandingly stable contract law codification in the nineteenth century, none of the countries emerging from the four empires mentioned above qualifies for selection in our sample without numerous caveats clouding any methodological merit of including them. Nor do any of these former imperial entities present such a clear-cut case as North Korea to serve as validation of the importance of the codification of private contract law by counterfactual simulation. But to leave no stone unturned, we have considered Russia, the lead country of the former socialist and now transforming bloc of countries in one of our robustness checks. Following LOT in ascribing Austria to the German legal origin, we consider its legal structures to be perfectly represented by the "mother country" Germany, although Austria's civil code is older than Germany's.

It might have seemed equally tempting to include other countries for their outstanding economic performance over prolonged periods of time, such as Australia, Canada or Singapore among common law countries or the civil law countries Belgium and the Netherlands. Obviously in settler societies such as Australia and Canada and in multicultural city–states such as Singapore, the transplant effect, which precludes inclusion of the bulk of former colonies from our selection, is obviously less significant than in countries with their own ancient traditions such as India. And there is no doubt that the code Napoleon was greeted with enthusiasm by the emerging entrepreneurial class of Belgium and the Netherlands as an emancipation of contract law from feudal restrictions. But we consider the legal structures of the first three well represented by the mother country UK-England (except for Australia's and Canada's resource wealth) and the last two by the mother country France.

As it happens, five of our eight countries are of what LOT considers as "German" legal origin (Germany, Japan, South Korea, Switzerland and Taiwan). To avoid objections of bias, we emphasize three points at the outset:

1. For reasons of methodological coherence, we arrive at our sample first by elimination (i.e. of countries with transplant effect, socialist countries, transforming countries, Scandinavian countries), and then by focusing on paradigm countries, i.e. mother countries of legal origin and other countries with both independent legal histories and distinctive patterns of economic development.
2. For reasons of comparative law explained in Sect. 3.2.3, we do not share LOT's characterization of Japan, South Korea and Taiwan as countries of "German" legal origin.
3. For those preferring LOT's characterization of the legal origin of these three countries as "German", our analysis may have the useful side effect of filling some of the cognitive deficit concerning the German legal origin recognized by

LOT itself ("Although less has been written about German law [than about French law], it is fair to say that it is a bit of a hybrid" (La Porta et al. 2008, p. 304). In fact, we show that the superior economic performance of the set of countries counted by LOT as of German legal origin between 1960 and 2000 is owed in large part to Asian countries which have designed their civil codes autonomously in a "comparative law method" rather than as merely "receiving" German law.

Just like LOT, we have controlled economic data for a number of biases. However, we have opted for a different set of controls relevant for the different set of countries we consider. We do not consider ethno-linguistic or religious divisions (such as in Switzerland) as an inescapable impediment to growth (Easterly and Levine 1997), nor temperate climate as an economic advantage (Diamond 1997). We have, instead, controlled for time and country fixed effects. These fixed effects capture unobserved heterogeneity, i.e. all country-specific, time-invariant factors that we do not specifically observe (preferences, historical factors, other institutional factors, etc.), and all time-varying factors that are common to the eight countries in the sample (see Sect. 3.3.4).

3.2.3 Short Reviews of the Legal and Economic Histories of the Countries Selected

As nicely stated by Roe and Siegel (2009, p. 799), a critical analysis of LOT's assumptions from a comparative law point of view such as Dam's (2006) may make many talented economists think twice before climbing on LOT's and DB's horse too quickly. We are not sure, whether the new finance literature will jump, instead, on the political economy horse offered by Roe (2006) and again by Roe and Siegel (2009). We would rather recommend the safer mount of institutional economics with strong legs in contract theory, which should be more congenial to economists. But we share Kenneth Dam's point that a deeper analysis of legal and economic history than LOT's is needed before making policy recommendations to transforming and developing countries as regards their legal reforms.

This section offers short reviews of the legal and economic histories of the civil law and common law countries in our sample. We focus on the history of codification of default rules in contract law, on major phases of economic growth since the mid nineteenth century and on the relative importance of bank finance and equity finance in the eight countries concerned.

3.2.3.1 Civil Law Countries

Since the Roman law tradition plays a central role in LOT's explanations of what it sees as inferior quality of civil law (La Porta et al. 1999), a few preliminary

clarifications are in order. Although Justinian, the Roman emperor who ordered the codification of Roman law in the sixth century, was a Christian, LOT's association of Roman law with Catholicism and Catholic lack of trust in professional insiders is, as mentioned in the introduction, evidently questionable. The confessional division between Catholicism and Protestantism occurred 1,000 years after the Justinian codification of Roman law and prosperous Protestant regions in Southern France and Northern Germany continued to apply Roman law principles collected in the "Pandects", a digest of legal opinions on Roman law (Goudsmit 2005). Nor is Roman law correctly understood as the expression of the will of the rulers such as assumed by LOT's political theory where it categorizes the Roman, French and German codes as creations of Justinian, Napoleon and Bismarck respectively. Hayek, as quoted above, has identified it as a body of jurisprudence, which emerged centuries before Justinian in a legal process very similar to the later English common law. The principles of private property and private autonomy for concluding contracts are crucial principles of Roman law (Robaye 1997; Zimmermann 1990).

France Contrary to LOT's assumptions, France's civil and commercial codes of 1804 and 1807 respectively are not pure reflections of Roman law. They are a composition of the medieval customs of Northern France, which were culturally close to the customs of medieval England, and of elements of Roman law, which had remained in force in Southern France since Roman times. Hence, for about a millennium, France was a country legally divided into two major parts, inviting analysis as a quasi-natural experiment capable of comparing the economic effects of institutions more reliable than cross-country analyses with large samples such as LOT's (Acemoglu et al. 2005; Le Bris 2013 and the sections of this chapter dealing with the cases of China, Germany, India–Burma, and Korea). Just like England before the amalgamation of local customs into common law, France's ancien régime had to cope with the fractured landscape of countless local customs, especially in the northern part. Therefore, legal and economic integration was a major goal first of the French revolution and then of Napoleon. Portalis, the most influential voice among the drafters of the *code civil*, managed to strike a balance between tradition and modernity. In the end, the customs of Paris prevailed over other local customs. Their impact on the code is at least as strong as that of Roman law (Ourliac and Gazzaniga 1985, p. 358). If theories of economic integration are right to assume that the elimination of legal particularisms within, as well as between, national economies is conducive to economic growth, the codes of 1804 and 1807 have plausibly contributed to France's subsequent economic development. Among all other civil codes, the French codes stand out by their elegant and accessible style. Henceforth, contract rules were easy to check and understand by any contracting party (Murdock 1954).

Of course, France's economic history of the nineteenth and twentieth centuries is as much characterized by cyclical and secular factors as that of the other major countries considered. The following stand out in the period our data covers: the boom years of the second half of the *Second Empire* (1860–70), at the end of which

the size of the French economy drew even with the British economy. The Third Republic inherited the recession (1872–1878) caused by the defeat of the *Second Empire* in the Franco-Prussian war. A recovery in 1878–88 was followed by a flat growth until 1903, growth exceeding Britain's 1904–1914, the recession caused by World War I until 1921, and a remarkable recovery until the onset of the great depression. The period after World War II saw new cyclical swings and more proactive policies designed to affect them (Price 1981) just as in Britain before the Thatcher government. Hence the French civil and commercial codes do seem to correlate just as plausibly with economic performance as the English common law. They do so despite France having lacked the highly developed capital markets associated by LOT with the common law.

Since indirect finance, on which France's enterprises had to rely primarily until the early 1980s (Schmidt et al. 1998), is considered by economic theory as only a second best solution, France's civil and commercial codes must have scored through other advantages, and for reasons explained in Sect. 3.2.3.4, we propose to consider their contract rules. On the other hand, a shift towards securitization both on the asset and the liability side of French non-financial sectors indicates that France has been changing from a bank-based to a market-based financial system ever since the early 1980s (for more details, see again Schmidt et al. 1998). This change suggests that functioning equity finance may just as easily develop in association with civil law as with common law, an argument already made by Roe (2006) with respect to Switzerland.

Germany Germany's civil code, the *Bürgerliches Gesetzbuch* (BGB) of 1887 is a much less mitigated transmission of Roman law to a modern economy and society than France's. Bernhard Windtscheid, the foremost representative of the "pandectist" tradition in Germany at the time, prevailed in its design. The entry into force of the *BGB* in 1900 was preceded by the commercial code of the German Confederation (*ADHGB*) of 1861. The *ADHGB* was the single most important legislative achievement of this otherwise rather powerless confederation (Kraehe 1953). It provided not only special rules for the contract types most important for commerce at the time (sales, agency, forwarding and freight), but also, more crucially for economic integration, general default rules for all contracts concluded by business enterprises in the German Federation as part of their business. It deferred to the civil laws of Germany's many states only for those matters it had left untouched. It remained in force even after Germany's unification in 1871 until the new civil and commercial codes of the German Empire promulgated in 1896 and 1898 respectively became law in 1900.

Germany's civil code of 1896 and commercial codes of 1861 and 1898 were not, as LOT assumes, "introduced by Bismarck" (La Porta et al. 1999, p. 231, implying an illiberal inspiration of the code), but emerged from the German codification movement of the nineteenth century that began in Austria in 1811, long before Bismarck became German Chancellor (in 1871), succeeded in the adoption of the *ADHGB* by the German Confederation (which included Austria) in 1861 and culminated in the passage of the *BGB* in the Reichstag in 1896, long after Bismarck

was gone. The movement was inspired and pushed through by liberal pro market forces in Germany which had the overwhelming majority in the Reichstag and with whom the ultra conservative Bismarck had to compromise on economic issues, like a "hat-in-hand chancellor" (Ozment 2004), in order to obtain their consent on the foreign and military matters foremost on his mind (Born 1970; Gall 1990).

Germany was just as affected as Britain and France by most of the cyclical and secular events of the nineteenth and twentieth centuries. The taking-off of the "Gruenderzeit" (era of enterprise founders) of the decade of 1860–1873 was even more pronounced than France's. By the first decade of the twentieth century German industry pulled ahead of Britain (Wilson 1962; Ritschl 2004). Extra-ordinary negative events for the German economy were the two world wars and the interwar period. Throughout World War I, the German economy suffered a major productivity shock. The Versailles Peace Treaty diminished its coal and steel capacities by about 40 % through territorial changes, and compulsory coal exports to Allied victors reduced its energy base. A dysfunctional monetary policy response to war reparations imposed by the Versailles Treaty on Germany provoked the hyper-inflation of the early 1920s, which eroded private capital formation and hampered long-term credit throughout the inter-war period (Ritschl 2004). Hitler's autarky policy disrupted prewar inter-regional specialization patterns, his planned war economy built up hidden inflation. World War II brought the total destruction of the physical capital of the German economy. Reliable economic data on the German economy in the world war and inter-war periods are extraordinarily difficult to obtain and continue to be subject of intense statistical debate (Hoffmann et al. 1965; Lewis 1978; Maddison 1982, 1991, 1995, 2001; Fremdling 1988, 1991; Feldman 1993; Broadberry 1997; Ritschl 2002, 2004).

The same is true for the postwar period between 1945 and 1947, when the German state had ceased to exist and the economy was divided in four occupied zones. Since, evidently, even a functional legal environment for business cannot prevent the negative economic impact of wars, we might have interrupted our long term time series in 1914 and only resume it in 1949, when the Federal Republic of Germany (West Germany) was established with the civil law code intact. We resolved to refrain from doing so and were able to obtain robust results confirming our hypothesis for the entire uninterrupted period of 1870–1990, the year of Germany's reunification (see Sect. 3.3.4).

While a legal system cannot prevent the economic impact of wars, we assume that it can be crucial for a rapid recovery. Germany's civil law was certainly not a sufficient condition, but it was plausibly a necessary one for the West German economy's postwar "economic miracle" (for more details, see Schmiegelow 2006, see also Eichengreen and Ritschl 1997). Germany's contract law was all the more crucial in this performance, because of the importance of small and medium enterprises (SME, or the so-called "hidden champions", Simon 1996) in the West German economy, which for reasons of cost and time could not afford to hire lawyers specialized in the expensive business of drafting complete contracts, but instead had to rely on default rules, an available public resource, in their contracts with suppliers and customers at home and abroad. The role of SME's, dependent on

bank finance, in the German economy is also one of the explanations why Germany remained a Gerschenkronian "backward" economy even longer than France, having to rely to a much larger extent on financial intermediation up to the present time (Krahnen and Schmidt 2004).

With the German reunification of October 1990, the Federal Republic of Germany (the former West Germany) integrated the former GDR, a member of LOT's socialist legal origin. Although the entire West German legal system including the civil and commercial codes was reintroduced to East Germany, reunited Germany became partially a "transforming country". At that moment, unification produced a drop in real GDP per-capita of about 10 % (Canova and Ravn 2000). The interpretation of data for post-1990 unified Germany presents major difficulties for econometric analysis, and particularly so when it comes to comparing the economic effects of legal origins. Maddison (2001, pp. 30 and 31, 2003, pp. 177 and 178) attempted to construct all-German data for the period of 1949–1990 by extrapolating the integration of historic West German and East German data backwards to 1949. The result blurs the differences between a market economy of German legal origin and a planned economy of socialist legal origin in one country. Hence, we have used Maddison's (1995) data for West Germany (1949–1990) up to the end of our time series in 1990 in one of our robustness checks.

Japan Japan is not only (debatably) categorized by LOT as a country of German legal origin, but its economic development in the twentieth century shows patterns remarkably similar to those of Germany, though, in many instances, on a larger scale. Its civil code of 1896 and its commercial code of 1898 are the paradigm cases of voluntary and selective integration of various Western patterns in the codification of civil law in non-Western countries. The French advisor Gustave Emile Boissonade de Fontarabie authored the first drafts very much using French patterns. They almost became law in 1890. Deft opposition by Japanese scholars belonging to what was then called the "English School" of legal thought in Japan prevented its adoption, however, and a further period of reflection followed. The struggle between the "postponement faction" and the "immediate-enforcement" faction took on some aspects of the Thibault-Savigny controversy in Germany as well as of the struggle between natural law philosophy and the historical school or between universalism and culturalism (Schmiegelow 2006 with further references). Finally, a large number of Japanese scholars returning from Germany, where they had closely followed the debates about the 1887 and 1896 drafts of the *BGB*, prevailed with their advocacy of amalgamating French and German patterns with domestic traditions in a new draft. Their draft became law in 1897, 3 years before the 1886 Reichstag *BGB* bill entered into force in 1900 (see Tanaka and Smith 2000). Berkowitz et al. (2003 on page 180), emphasize that this type of voluntary transplant to what they call a receptive country, correlates with a high degree of effectiveness of legal institutions. The closest remaining link between Japanese and German law is a continuing exchange on legal theory, case law and legislation (see Murakami et al. 2007). We propose to abandon the term "transplant" altogether

and identify the Japanese paradigm as the comparative law method of legal transformation.

The Japanese Commercial Code of 1898 became law in 1899, a year earlier than the Commercial Code of the German Reich. Remarkably, it was the first Commercial Code of civil law countries to provide default rules for insurance contracts, a decade earlier than Germany's Insurance Contract Law of 1908 (Kozuka and Lee 2009).

Later, Japan's postwar economy, as did Germany's, rose like a phoenix from the ashes after the destruction of its physical capital in World War II. Japan's GDP overtook Germany's at the end of the 1960s as Japan's per capita income drew even with Germany's. Japan and Germany have been the second and third largest economies of the world after the US for four decades, before being predictably relegated to third and fourth places by China. That the allies left the civil law codes of both countries untouched—while insisting on deep reforms of competition and banking laws—means that it is all the more plausible that the function of default rules in contract law is a necessary condition for economic recovery. The salience of this function is further increased by the fact that Japan's and Germany's economic recoveries proceeded with similar dynamism although the economic policy philosophies of the two countries differed fundamentally, with Germany dogmatically attached to ordoliberalism (Streit 1992), while Japan developed an intriguing pattern of strategic pragmatism (Schmiegelow and Schmiegelow 1989).

Just as in France and Germany, indirect finance prevailed in Japan until the 1980s (Patrick 1962; Suzuki 1980). Both the prewar *Zaibatsu* and the postwar *Keiretsu* were built around the main banks and Japan's myriad SME depended on bank loans, as did the big conglomerates. However, financial intermediation became dysfunctional in the bubble economy of the late 1980s, and it practically ended after the bursting of the bubble, when Japan entered the deflationary period of its "lost decade" (Yoshikawa 2002; Koo 2003; Krugman 2009). Banks were allowed to keep their non-performing loans on their balance sheets, as a consequence confidence in the inter-bank market collapsed and lending to enterprises stopped. Only in 2003, did the Koizumi government succeed in compelling the banks to write down the non-performing loans according to international fair value standards. The banks resumed lending and the economy recovered immediately with 6 % annualized growth in the fourth quarter of the same year (see details in Schmiegelow 2003).

South Korea and Taiwan While Japan was a paradigm of the comparative law method for its own civil and commercial codes, Korea had to accept the same codes as a colonial transplant, when it became Japan's protectorate in 1905 and its colony in 1910. Korean society was, however, remarkably receptive to the modernizing potential. Hence, it is not entirely surprising that the independent South Korea, which emerged in 1948, voluntarily adopted a civil code in 1958 and a commercial code in 1962, both drafted by Korean legal scholars educated in the dogmatic foundations of the Japanese codes, but distinctive in substance and style (Kim 2000, 2008; Kozuka and Lee 2009).

Like South Korea, Taiwan was living under the Japanese civil law code from 1897 to 1945. The Japanese code continued to be pragmatically applied until 1949, when Chiang Kai-shek took effective control of the territory. The Chinese civil code, which Taiwan adopted in its autonomous identity as the Republic of China in 1950, was in the making on the Chinese mainland since the end of the nineteenth century. In China's civil law tradition, it is important to distinguish the following phases. Beginning with the Opium War of 1840–1842, China came into contact with Western legal culture and was pressured by Western powers to introduce a Western-style civil code (see Han, Chap. 13 of this book). But Qing Dynasty officials completed their Civil Code Project only in August 1911. The Qing dynasty collapsed soon after and the project therefore never became law. The Republic of China, founded in January 1912, made a fresh start. A Committee for Codification produced a civil code, which was promulgated by stages from 1929 to 1933 and, following the German and Swiss pattern, included a special Insurance Law enacted in 1929, which combined organizational regulations for the insurance industry with rules for insurance contracts. These were the first codifications of contract law in Chinese legal history and, with various modifications in past decades, have been adopted in Taiwan in 1950 as an autonomous replacement of the colonial transplant of Japanese law in force until then. They correlate plausibly with Taiwan's emergence as a high growth economy since the 1950s. After assuming political control over Mainland China in 1949, the Communist Party repealed this civil code and replaced it by a socialist system on the Soviet model. Subsequently, the Chinese central authorities attempted several times to draft a socialist civil code, first at the beginning of the 1950s and again at the beginning of the 1960s. Both attempts failed because of the prevailing influence of the "legal nihilism" of the Communist Party (see Xu 2004, p. 19). When Deng's reforms began in 1978, the liberalization of the economy enabled a demand for a legal framework for private contracts to rise gradually. The Contract Law of 1999, which was adopted by the Ninth People's Congress, follows UNIDROIT principles to a considerable extent. This is a remarkable step in legal transformation and may have contributed to the acceleration of Mainland China's growth in the last decade. But again, for reasons of methodology, we refrain from including transforming economies in our analysis.

South Korea's and Taiwan's economic development followed Japan's pattern in what became known as the "Flying Geese" formation (Akamatsu 1962). Just as in the case of the German–Japanese duo, the salience of the function of their contract law is plausibly increased by the fact that their economic development proceeded with similar dynamism although their economic policy philosophies differed fundamentally. Taiwan was committed, like Germany, to promoting a model of atomistic competition with SME enterprises prevailing, whereas South Korea, like Japan, favored *chaebols*, big conglomerates reminiscent of Japan's prewar *Zaibatsu* (Schmiegelow 1991).

In both countries the pattern of intermediate finance prevailed in the past six decades. South Korean and Taiwanese banks were state-owned until the end of the 1980s. And just as in the case of Japan, credit to the real economy was rationed as

long as the financial system was illiquid, as was the case up to the end of the 1980s (Noland 2005; Liu and Hsu 2006).

Switzerland Significantly, Switzerland codified contract law before all other areas of classic civil law. It joined the European codification movement in 1881 with Walther Munzinger's draft of a Swiss law of obligations (*Obligationenrecht*) focusing on contracts and including commercial law (Bucher 1988). The draft was adopted by the Swiss Confederation in 1881 and came into force in 1883. In 1912, a revised, but essentially similar version was integrated into Switzerland's first comprehensive civil code (*Zivilgesetzbuch*) as its Part Five. Although the Swiss codification is frequently described as following the German example, its style is praised as more accessible than the German codes. Unsurprisingly, therefore, the Chinese civil code of 1929, which, as mentioned above, has been in force in Taiwan since 1950, shows more borrowing from the Swiss code than from the German one (Bucher 2006). The contract types, however, are similar. Switzerland's *Versicherungsvertragsgesetz* of 1908 (Insurance Contract Law) follows the pattern of the German insurance contract codification of the same year (Reichert-Facilides 1998).

Although Switzerland is a small country, its history, economy and civil law constitute a case casting doubt on some of the bolder assumptions of LOT about the comparative quality of common law and civil law. Of course, a one-country case cannot offer robust econometrics. But in the philosophy of science, a single case can refute a conjecture (Popper 1963). A few rankings illustrate the significance of the Swiss case, counterintuitive by LOT's assumptions, as both a civil law country and a financial center. From 1870 to 1950, the Swiss economy achieved the highest average growth rate of all European countries including the UK. That growth was driven by both the industrial and service sectors (David and Mach 2007). Switzerland's emergence as a financial center began in the early twentieth century on the basis of a pronounced relationship of trust built up between banks and clients as analyzed by Swiss financial historians in terms strikingly reminiscent of LOT's paradigm of trust in protestant common law countries (Vogler 2006). A century later, the Swiss economy boasted the highest share of equity market financing in the world at more than 200 % of GDP. Neither significantly bigger countries (such as Germany, France, the UK, or the US) nor similarly small trading nations (such as Ireland or Austria) come anywhere near that level (Brändle and Jörg 2010). At the same time, Switzerland ranks fifth worldwide in bank assets, with UBS and Credit Suisse positioned among the top ten. Just as in Germany, SME play a major role in the economy. While Switzerland's big corporations rely on equity finance, its SME depend on bank finance. More than 90 % of corporate loans of Switzerland's banks go to SME. Swiss reinsurance groups account for more than 15 % of global premiums, ranking third worldwide after Germany and the United States. Switzerland is a global leader in private wealth management, with a one-third share of assets among global cross-border private wealth managers. Switzerland is the second largest market of hedge funds (FoHF) worldwide after the United States. In 2007, the Swiss financial system contributed about 15 % to Swiss GDP, far ahead of the 8 % in the US and 9 % in the UK (IMF 2007; Haldane et al. 2010).

3.2.3.2 Common Law Countries: UK and US

The uncertainty of judicial discovery of "implied rules" and the complexity and cost of writing clear text contracts for every conceivable business situation has been recognized in common law countries in at least three historical phases, each inspired by interest in the comparative functional quality of codified contract rules in civil law countries.

The first phase, in the second half of the nineteenth century, led to the "codifying statute" on the sale of goods in the UK, the Sale of Goods Act of 1893 (Atiyah et al. 2005). The entire common law was codified to speed its diffusion in the British Empire, more particularly in India. Intellectually, this effort was guided by Jeremy Bentham's constructivist rationalism and the perception of a cultural incompatibility between English common law and "native" legal traditions (Wilson 2007). Bentham shared the interest of the continental European legal positivists in codification (von Hayek 1973). India's Contract Act of 1872 codifies four economically important contract types: sale of goods, guarantee, bailment (delivery of goods) and agency. In theory, with this score of 4 as against the UK's 1, India's economic performance should have overtaken the UK's already by the end of the nineteenth century. In reality, India rather stands out as one of the leading cases of the theory of the failure of colonial transplants (Berkowitz et al. 2003). India's Prime Minister Manmohan Singh, one of the few professional economists among the world heads of government, presented a harsh reckoning of India's past development failures in his address at the occasion of the 60th anniversary of India's independence in 2007 (Singh 2011). The World Bank IFC Doing Business Report (2011) ranks India, the biggest common law country, 182nd out of 183 countries for contract enforcement. Hence, we had to eliminate India from our analysis, but used it as a robustness check in one type of contract: labor contract.

The second phase of interest of common law countries in codifying contract law occurred in the mid twentieth century. It was driven by the "restatement" movement in the US and led to the adoption of the Uniform Commercial Code (UCC) in all States of the US from 1953. According to Crystal (1979), it was a period of intense transatlantic exchange between comparative lawyers and of a remarkable interest of American legal scholars in functional solutions offered by civil law. Just like the UK Sale of Goods Act of 1893 and its modernized version of 1979, the UCC focuses on the sale of goods (Article 2). But Article 2 UCC also serves as a welcome source of arguments by analogy for contracts in other areas. Moreover, Article 4 UCC, on bank deposits and collections, also offers default rules for bank customers taking loans from their bank, which led the US a step further than the UK in the process of codifying default rules. The most important contract type codified in India since independence is the labor contract "Hiring Employees" (for more detail on the evolution of this protracted process see Deakin et al. 2007). Contrary to LOT's and DB's assumption that labor law codification tends to increase unemployment, Deakin and Sarkar (2011) have found no negative effect of India's labor

laws on employment between 1970 and 2006. In our robustness check in Sect. 3.3.4 below, we found a positive correlation with economic growth.

The third phase, towards the end of the twentieth century, was the emergence of new institutional economics with its debate on contract theory already mentioned in Sect. 3.3.1. As a result of this debate, given the growth of the modern leasing industry, and following an initial study by the American Bar Association, a Drafting Committee of the National Conference of Commissioners on Uniform State Laws (NCCUSL) produced the draft of a Uniform Personal Property Leasing Act. In 1987, this draft was incorporated as Article 2A in the UCC. By March 1994, this new Article was enacted in 39 states (Lawrence 1996). This is just one among many indicators of the convergence between civil law and common law, which is familiar to all students of comparative law (Dam 2006; Dannemann 2006; Schmiegelow 2006) and which has progressed further in the US than in the UK.

Both the UK and the US, however, continue to stand out as locations of the world's two largest financial centers even though there have been remarkable upswings and downswings as well as changes in their relative importance and composition. Equity finance historically prevailed over bank finance in the UK, while bank finance prevailed in the US until the 1930s (Eichengreen 2008). Since World War II, however, nonbank financial institutions and markets have become more important in the US reflecting the process of disintermediation and securitization. Data on financial markets reaching back to the nineteenth century are less than perfectly reliable and not easy to interpret. La Porta et al. (2008) have convincingly refuted data on stock market capitalization over GDP, on which Rajan and Zingales (2003) have relied to argue that the ratio was higher in civil law than in common law countries before World War II. Instead, LOT prefers data collected by Goldsmith (1985). These show the UK as the leading financial center from the 1880s to the 1930s, and the US thereafter.

3.2.3.3 The Debate on Non-legal Factors in Financial Market Development

The Goldsmith figures for France, Germany and Japan suggest a much weaker stock market development from the nineteenth century to the present, which is consistent with our remarks in Sect. 3.2.3.1 on the prevalence of indirect finance in these countries and Roe's (2006) argument that the absence of war destruction and foreign occupation is a necessary condition for the domestic development of equity finance. However, the Goldsmith figures, accepted by LOT, also show that Switzerland comes close to, or even at times overtakes, those of the US. These figures support Roe's suggestion that, given the absence of war destruction and foreign occupation, a civil law country can develop equity finance just as fully as the leading common law countries. La Porta et al. (2008) take issue with Roe's argument of war destruction sparing Switzerland while impeding the development of equity finance in all other developed civil law countries. They object that Roe considers developed countries only and argue that his correlation between war

destruction and low stock ownership dispersion disappears as soon as the larger LOT sample of countries including developing countries is used. Indeed, they sum up, "This may not be surprising: many developing countries stayed out of World War II and yet remained financially underdeveloped" (La Porta et al. 2008, p. 321). This argument is of questionable logic, however. Roe's hypothesis was not that all countries enjoying peace would develop financial centers, but only that countries not enjoying that privilege would not. A similar "logic" could easily be turned against LOT: many developing countries are of English legal origin and yet have not developed a financial center. Of course, we will not let ourselves be drawn in to such an argument.

As repeatedly stated, we posit that a functional legal environment is a necessary, but certainly not a sufficient condition of economic development (Schmiegelow 2006). A highly suggestive demonstration of the need for this qualification of LOT is Philippon's (2008) analysis of three large up-swings in the development of the US financial market since the mid nineteenth century interrupted by two major contractions.

Philippon proposes a model of interaction between corporate finance and technical innovation and relates the three up-swings of the US financial market to three great phases of industrial development: (1) railroads and heavy industry (1880–1900), (2) the "electrical revolution" (1918–1933), and (3) the "revolution of information technology" (1980–2001). If we consider that the two first phases of industrial development supported by financial intermediation through banks was shared very much by civil law and common law mother countries and that LOT's arena of argument has been limited so far to the 1980s and 1990s, when the economic performance of the US turned into a statistical outlier, a closer look at Philippon's third phase is in order. Indeed, the "revolution of information technology" has been marked by an axiomatic preponderance of the US. Hence, the superior performance of the US may be owed to a superior quality of an American technology rather than to the superior quality of common law assumed by LOT.

Again, we do not in the least doubt the quality of common law as an environment particularly favorable to the flow of capital to corporate insiders bound by fiduciary duties. In view of the Swiss case, however, we see only good reasons that civil law default rules build confidence of investors just as effectively—especially the good faith general clause—provided it is not destroyed by the intervention of wars and occupation as argued by Roe. Again, we warn against overreaching assumptions about the economic consequences of law. LOT would do well to retreat to the well-prepared position of institutional economics: law is a necessary, though certainly not a sufficient condition.

3.2.3.4 Codified Default Rules in the Contract Types Selected

The codes and statutes mentioned in the preceding survey of legal and economic data reveal *which country* has codified default rules *for which contract type* and *when*. Table 3.1 surveys the presence and absence of default rules for the ten

Table 3.1 Presence and absence of codified default rules for ten contract types in eight civil law and common law countries

	Countries							
	Civil law						Common law	
	Without financial center advantage					With financial center advantage		
Contracts	France	Germany	Japan	South Korea	Taiwan	Switzerland	UK	US
Renting office space	1804	1861	1897	1958	1950	1883	–	1987
Contracting for construction of a building	1804	1861	1897	1958	1950	1883	–	–
Purchasing equipment	1804	1861	1897	1958	1950	1883	1893	1953
Insuring equipment	1930	1910	1899	1962	1950	1910	–	–
Hiring employees	1922	1861	1897	1958	1950	1883		
Taking a bank loan	1804	1861	1897	1958	1950	1883	–	1953
Subcontracting work	1804	1861	1897	1958	1950	1883	–	–
Contracting with a commercial agent	1804	1861	1899	1962	1950	1883	–	–
Obtaining advice from a consultant	1804	1861	1897	1958	1950	1883	–	–
Guaranteeing an undertaking by a subsidiary	1804	1861	1897	1958	1950	1883	–	–

Presence: 1, indicated here by the year of first codification; Absence: indicated here by "–"
Authors' own compilation

defined contracts types in the eight selected countries. The table presents the years of the first codification of specific default rules for each of the ten contract types in each of the eight countries, although subsequent codes or statutes may have changed or refined the rules.

In France, the *code civil* of 1804 was the first modern codification offering default rules for eight of our ten contract types (Bénabent 2004). Codification of labor and insurance contracts followed by the *code du travail* (Labor Code) of 1922 (Lyon-Caen 1955) and by the *Loi sur le contrat d'assurance* (Insurance Contract Law) of 1930 (Reichert-Facilides 1998). In Germany, the *ADHGB* of 1861 of the German Confederation preceded the *BGB* of 1896 and the *HGB* of 1897 of the German Reich, both in force since 1900, in providing default rules for nine of our ten contract types (Basch 1890; Oechsler 2008). The *Versicherungsvertragsgesetz* (Insurance Contract Law) of 1908, in force since 1910, was the first German codification of insurance contracts. Similarly, the Swiss Law of Obligations of 1881, in force since 1883, which preceded the Swiss Civil Code of 1912, codified nine of our ten contract types, while insurance contract law was codified in 1908 as in Germany (Reichert-Facilides 1998).

The Japanese Civil Code of 1896, in force since 1897, codified eight of our contract types, while leaving the first codification of commercial agents' contracts

and insurance contracts to the Commercial Code of 1898, in force since 1899. The Korean Civil Code of 1958 and the Korean Commercial Code of 1962, while otherwise remarkably distinct, followed a similar legislative technique, with the former codifying the eight most general contract types and the latter commercial agent's and insurance contracts (Kozuka and Lee 2009). The Civil Code of the Republic of China, in force in Taiwan since 1950, follows German and Swiss patterns in offering default rules for nine of our contract types, while leaving insurance contracts to a special law, the Insurance Law of 1929 of the Republic of China, in force in Taiwan since 1950 (Lin 2010; Jao 2008).

As we have seen, the UK codified default rules for only one of our ten contract types, the purchasing of equipment. The Sale of Goods Act of 1893 was followed by Sale of Goods Act of 1979, similar in style and codifying technique (Atiyah et al. 2005). Hence we count the first of the two codifying statutes. Two of our contract types benefited from the first codification of default rules in the US, sales contracts in Art 2 and bank loans in Art 4 of the Uniform Commercial Codes enacted in all US States since 1953. One more, renting office space, was added in 1987 in Art 2 A UCC on leases, and although enactment of this addition took several years in the different states, we have used the year of its adoption by the NCCUSL in Table 3.1. Even though common law prevails in a state as long as it has not enacted Art 2A UCC, lawyers and judges will tend to use its principles by anticipatory analogy (Lawrence 1996).

Table 3.1 shows that all eight countries of our sample provided codified default rules for at least one of the ten contract types. The six civil law countries in our sample codified such rules for all of the ten contract types, whereas the two common law countries of our sample did so for only 1 (UK) or 3 (US). In view of the importance accorded to default rules by contract theory, we hypothesize that their greater number in the contract law of civil law countries than in common law countries should have compensated for the comparative weakness of equity capital supply in those civil law countries in our sample, which did not enjoy the advantages of the UK and the US as locations of financial centers. This compensating effect should be detectable in their comparative economic performance over significant periods of time.

The length of the periods since the codification of the contract types in our sample countries should be sufficient to show a lasting footprint in their respective economies: two centuries for the eight initial contract types in France, one and a half centuries for the nine initial contract types in Germany, well over a century for the first complete codification of all ten contract types in Japan, just a century for the first codification of insurance contracts in Germany and Switzerland, 88 and 80 years respectively for the first codification of labor contracts and insurance contracts in France, half a century for the enactment in Taiwan of the full set of ten contract types previously codified in 1929 by the Republic of China, as well as for the independent codifications in South Korea. And the period between 1870 and 2008, for which reliable per capita GDP data are available for all eight countries should offer a reflection of this footprint in terms of at least a convergence with the performance of the UK and the US. The hypothesis could be further strengthened, if

Switzerland, which combines civil law and financial center advantage, outperformed the UK and the US.

3.2.4 Economic Performance of Selected Countries

Figure 3.1 shows the evolution of the per capita GDP growth rate of our eight countries from 1870 to 2008, using the historical Maddison data on GDP (Maddison 2001 except for West Germany (1949–1990), for which we use the data of Maddison 1995 to avoid the backward extrapolation of the data of the former GDR as explained in Sect. 3.2.3.2). It reveals a suggestive pattern of convergence between civil law countries and common law countries, although with massive interruptions in the war and interwar periods. The recoveries of France, Germany and Japan after the World War II appear as impressive as the sustained catch-up process of the two newly industrialized countries South Korea and Taiwan. The fact that three highly developed civil law countries without financial center advantage could overtake the UK after World War II suggests that the impact of the codification of a full range of ten economically important contract types may overcompensate the comparative weaknesses of the flow of equity capital. Our hypothesis is further confirmed by Switzerland's combining the full range of codified default rules, financial center advantage and a per capita GDP exceeding that of the UK in two interwar decades, and the six decades since the end of the World War II, as well as that of the US between the mid-1950s and the mid-1980s. That the Swiss economy fell back compared to the US economy in the 1990s can be explained by factors beyond contract law and financial center status. The phenomenon correlates with the simultaneous occurrence of the outlier performance of the US explained by Philippon (2008) on the one hand, and the Swiss recession from 1990 to 1996, a steady appreciation of the Swiss franc hurting Swiss export industries, and a new divisiveness in its domestic politics (David and Mach 2007). This is another reminder that well-designed default rules in codes and statutes can constitute only a necessary, but not a sufficient condition of economic performance.

3.3 Empirical Results

We analyzed the relationship between economic performance and the history of contract law since the nineteenth century. We made the assumption that, all other things being equal (rebus sic stantibus), the codification of default rules for economically important contract types influences the economic performance in the codifying country, since it reduces transaction costs and information asymmetries by offering default rules for incomplete contracts.

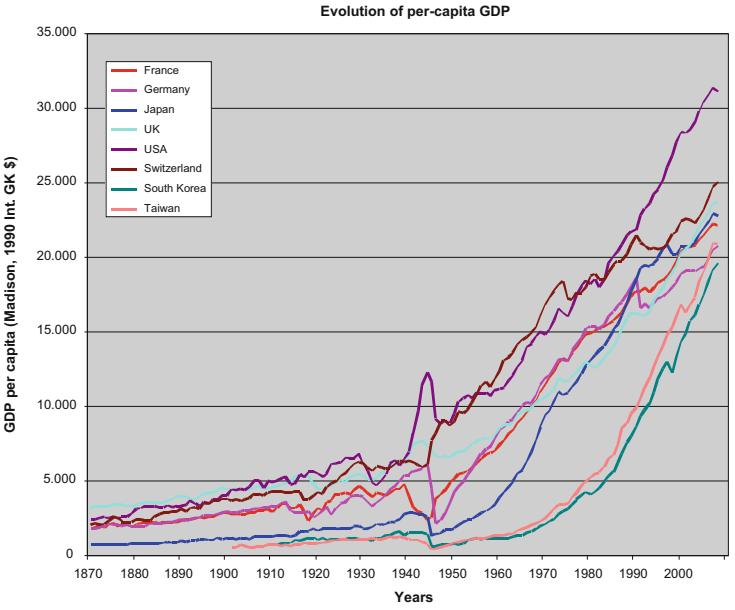

Fig. 3.1 Evolution of per capita GDP 1870–2008. *Source*: authors' calculations

3.3.1 Specification

We specify the following linear panel data model, commonly known in the growth literature as β-convergence model (Sala-i-Martin 1996; Quah 1996; Arbia and Piras 2005, etc.):

$$\Delta \ln Y_{i,t} = \alpha_i + \alpha_t + \beta \ln Y_{i,t} + \gamma (Default\ rules)_{i,t} + \varepsilon_{i,t} \tag{3.1}$$

where the dependent variable ($\Delta \ln Y_{i;t} \equiv \ln Y_{i,t+1} - \ln Y_{i,t}$) is the annual growth rate of per capita GDP in country i between years t and t + 1, $\ln Y_{i,t}$ is the log of GDP per capita at the beginning of the period, $(Default\ rules)_{i,t}$ is an indicator of the presence of codified default rules at time t and $\varepsilon_{i,t}$ is the well-known error term.

Our coefficient of interest is γ; it measures the nature of the short-term impact of codifying default rules for contracts important for business on economic growth. This model is stable if β is significantly negative such that $\beta \in [-1; 0]$. As Eq. (3.1) specifies the conditional convergence, GDP per capita at country level will converge to its country-specific steady state value in the long run, and -β determines the speed of convergence toward the steady state. Thus, the long-term effect of codifying a contract type with default rules is equal to the ratio $(-\gamma/\beta)$.

We controlled for country fixed effects, α_i and for time fixed effects, α_t. In cases of specifically targeted legislation or regulations with limited time horizon, it is also necessary to test the incidence of other reforms (Bertrand et al. 2004). This issue is

however technically hard to tackle in two dimensions. Furthermore, our model deals with the permanent impact of the codification of legal rules for the most basic type of transaction in market economies, i.e. contracts, on economic performance (See above Sect. 3.1.1). This implies that more specifically targeted reforms with shorter time horizons will not influence the results. We choose to estimate the fixed effect panel data model by using the Least Square Dummy Variable (LSDV) approach. Indeed, following Islam (1995) and Arbia and Piras (2005), with the application of the panel data approach on convergence problems, it is not necessary to keep the steady state constant, since this can be directly estimated from data by using a LSDV estimator.

Other specifications will be used alternatively, especially if the β estimated coefficient is not statistically significant. One may attempt to explain the growth rate of GDP per capita as in the endogenous growth model (Romer 1986) rather than the level of GDP per capita as considered in the β-convergence model. We can then estimate the following equation

$$\Delta \ln Y_{i,t} = \alpha_i + \alpha_t + \gamma(Default\ \ Rules)_{i,t} + \varepsilon_{i,t}. \tag{3.2}$$

An autoregressive model can be also useful in our case study and helps potentially reduce the serial correlation. Indeed, for observations over a long period of time, data at a particular time t are highly correlated with the values preceding and succeeding them. An autoregressive (AR) process of order p is represented as

$$\Delta \ln Y_{i,t} = \alpha_i + \alpha_t + \sum_{j=1}^{p} \varphi_j \Delta \ln Y_{i,t-j} + \gamma(Default\ \ Rules)_{i,t} + \varepsilon_{i,t}, \tag{3.3}$$

where $\varphi_1, \ldots, \varphi_j, \ldots, \varphi_p$ are the parameters associated to the lagged variables of the model. The dependent variable is a function of its own lagged values and the other independent variables. A particular case is the first-order autoregressive model, AR(1), which can be written as (subscript on φ_1 is dropped):

$$\Delta \ln Y_{i,t} = \alpha_i + \alpha_t + \varphi \Delta \ln Y_{i,t-j} + \gamma(DefaultRules)_{i,t} + \varepsilon_{i,t}. \tag{3.4}$$

Thus, an AR(1) implies that the GDP per capita growth rate at time t depends on itself at the previous time $t - 1$ and on the other independent variables. We will deal with these two specifications [Eqs. (3.2) and (3.4)] for the robustness issue.

3.3.2 Econometric Issues

One can suspect the existence of an endogenous variable in the AR(1) model. Indeed, ln $Y_{i,t}$ appears on both sides of Eq. (3.1) causing an endogeneity problem. We may also think that the legal framework is correlated with other factors included

in the error term, such as the organization of the society. To be convinced by this hypothesis, we will conduct the Hausman test for endogeneity. The appropriate method of estimation is the instrumental variable (Two Stage Least Square) technique. Before embarking on this estimation, we first conduct the Hausman test checking for the endogeneity of log of GDP at time t. By construction, the coefficient β contains the Nickell bias in this kind of dynamic panel data model with fixed effects (Nickell 1981). The null hypothesis of exogeneity of log of GDP per capita at time t is rejected at 10 % (p-value of the Hausman test equals 0.08). The instrument must be correlated with the endogenous variable and not with the error term. In this kind of model the most indicated instrument is the first lag of the endogenous variable, i.e. the log of $Y_{i,t-1}$.

Our data set is a 1 year unbalanced panel running from the nineteenth century (1870–2008). The data we are using are the growth rate of GDP per capita as a proxy of economic performance and the default rules indicator. As explained above, the historical Maddison data (Maddison 1995 for post-war West Germany, and Maddison 2001 for all other cases) are the source of this variable. Figure 3.1 shows the evolution of the per-capita GDP for our sample countries. One observes a similar evolution (except during the World War II period for the US) until 1990, when US per capita GDP grows faster than the rest of the sample countries. Most significant from the standpoint of LOT, however, is that three civil law countries of our sample (the mother countries) began to overtake the UK after World War II, in spite of their lacking the UK's advantage of being a major financial center, and that Switzerland, which combines civil law with financial center advantage, outperformed even the US from the mid-1960s to mid-1980s. The outlier performance of the US after 1990 was the consequence of the faster development of the US financial industry based on the simultaneous extraordinary growth of the US information industry, as pointed out by Philippon (2008, see above Sect. 3.2.3.3). The sudden decrease of Germany's GDP in 1991 reflects the statistical effect of the integration of the socialist economy of the former GDR in the FRG (Canova and Ravn 2000, see above Sect. 3.2.3.1, p. 16).

We consider three different measures of the default rules indicator.

- Firstly, we measured it as a binary variable noticing the presence or absence of default rules for economically important types of contracts in codes and statutes. Taking this avenue, the dummy variable "Default rules" is equal to 1 if a country has codified at least one contract type offering default rules as listed in Table 3.1. In other words, it takes 1 from the year of codification and it is equal to 0 otherwise.
- Secondly, we considered the number of these types of contracts in codes and statutes. In this way, we can capture the differences between countries providing just one contract type with default rules and countries offering the full set of ten contract types.
- Thirdly, we constructed a dummy variable for each contract type offering default rules. This allows us to use ten different dummy variables where each of them captures the impact of default rules associated with each contract type. We

assume the exogeneity of the default rule indicator. From Table 3.1, it follows that the years of codification of default rules are not identical, while the countries have grown almost identically up to World War I. Additionally; specific fixed effects enable us to exclude an inverse causal relation running from growth to institutions. Hence, there are strong reasons to suppose that the codifications of default rules in our sample countries are not, inversely, caused by recent growth rates.

3.3.3 Benchmark Results

The results concern the fixed effects-OLS (Least Square Dummy Variable model) and the instrumental variable (Two Stage Least Square) regression. Our main estimate results are reported in columns 3–4 of Table 3.2. Under the FE-OLS in columns (1) and (2), the results show a positive correlation between the default rules indicator and the growth rate of GDP per capita. Thus, its impact on economic performance is positive and statistically significant when we control for fixed effects and when we use instrumental variable regression in columns (3) and (4). One can observe that the magnitude of the short-run impact of the number of contracts is smaller than the magnitude of impact resulting from the binary default rules indicator. This implies that the presence of at least one contract type containing default rules does matter in the short term. Furthermore, whether we consider default rules as a binary or as a continuous variable, the β estimated coefficient is significantly more negative than theoretically anticipated. For this reason, the β-convergence model is an appropriate specification. We will analyze the results obtained for the endogenous growth model and the first order autoregressive specification under the robustness checks in Sect. 3.3.4.

However, the binary variable does not capture the marginal impact of the first codification of one contract type with default rules. Table 3.1 shows that the contract laws of most of the countries of our sample are designed to codify more than one, and most often 8 or 9, contract types in one code at the same time, the UK being the only exception. Thus, the binary variable is not sufficiently precise to account for the difference in the number of codified contract types with default rules in the contract laws of our sample of countries: a value equal to one means codifying all of our ten contract types with default rules in the Civil Law countries of our sample, but in Common Law countries only the cases of either 1 (UK) or 3 (US) contract types with default rules exist. For this reason, we focus on the number of contract types with default rules. As an illustration, column (4) of Table 3.2 shows that codifying one additional contract type with default rules will increase the log of GDP per capita by 0.38 % in the short term, with a 95 % delta-method based confidence interval of [0.18; 0.58]. The long-run effect equals 13.3 % with a 95 % delta-method based confidence interval of [5.43; 21.24]. The speed of convergence toward the steady state value is equivalent to 2.85 %. Hence,

Table 3.2 Dependent variable = growth rate of GDP per capita

Unbalanced (eight countries)[a]					Balanced-mother countries[b]		Unbalanced (seven countries)[c]	
	FE-OLS		IV-2SLS		IV-2SLS		IV-2SLS	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Default rule	0.0162** (0.0067)		0.0178*** (0.0084)		0.0133 (0.0098)		0.0127* (0.0740)	
Nb of contract types		0.0035*** (0.0010)		0.0038*** (0.0010)		0.0037** (0.0014)		0.0038*** (0.0013)
Log of GDP per capita	−0.0136* (0.0078)	−0.0210** (0.0085)	−0.0208** (0.0083)	−0.0285*** (0.0091)	−0.0381** (0.0181)	−0.0478** (0.0161)	−0.0272*** (0.0105)	−0.0355*** (0.0118)
Constant	0.1145** (0.066)	0.1578** (0.0646)	−2.3018*** (0.0826)	−2.2444*** (0.0871)	−2.1242*** (0.1807)	−2.0507*** (0.2056)	−2.2323** (0.0104)	−2.1746*** (0.1108)
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R-squared	0.683	0.687	0.683	0.687	0.805	0.806	0.701	0.704
Chow test	0.612	0.608	0.611	0.607	0.272	0.269	0.561	0.557
Observations	1,033	1,033	1,025	1,025	549	549	919	919
Nb of countries	8	8	8	8	4	4	7	7

Notes:

FE-OLS fixed effects model tested with least square dummy variable technique, *IV-2SLS* FE tested with instrumental variable (two stage least square) approach, *Nb* number

[a]Unbalanced panel with eight countries (see Table 3.1)

[b]Balanced panel with four mother countries (UK, France, Germany, Japan)

[c]Unbalanced panel with seven countries (Taiwan excluded). Robust standard errors are in parenthesis. Instrumented variable: ln(GDP per capita); this endogenous variable is instrumented by using its own first lag (columns 3–8). Country and time dummies are not reported to save space. The values reported for the Chow test are the *p*-values for the null hypothesis of stability of the estimates on the two subsample periods: 1870–1939 and 1939–2008

*$p < 0.1$; **$p < 0.005$; ***$p < 0.01$

we can conclude that the codification of default rules for most economically important contract types favors economic growth.

To strengthen our findings, we have conducted a diagnostic test for the stability of the model parameters. Indeed, since we considered a long period of study, one may suspect that the estimates are not stable. The most appropriate test for stability is the Chow test. This test requires determining a breaking date or a structural break. Looking at Fig. 3.2, we can distinguish two major subperiods: a period of comparatively slow growth (1870–1939) and a period of strong growth (1939–2008). We then take 1939 as the breaking date. Under the null hypothesis, the Chow test stipulates that the estimated coefficients in these two regressions are equal. Columns (1)–(4) of Table 3.2 show that the *p*-value associated to the Chow test is substantially more than 5 % implying that the model parameters are Stable.

3.3.4 Robustness Checks

Naturally a check for robustness of this conclusion is required. We consider robustness along four dimensions.

Firstly, we check whether or not entry or exit of countries in our sample affects our estimation results. In columns (5)–(8) of Table 3.2, we report results obtained with instrumental variable regressions. FE-OLS results (available upon request) are very similar. In columns (5) and (6), we take only the legal systems mother countries: France, Germany, Japan, and the UK. In column (5), the dummy associated with the presence of default rules is not statistically significant. This non-significance could be explained by the fact that the UK (25 % of the four sample countries) has codified only one contract type with default rules whereas France, Germany and Japan have codified all of our ten contract types with default rules. Indeed, the positive relation between codified default rules and economic growth is statistically significant when considering the number of contract types containing such default rules. Hence, we have again found a positive correlation between codified default rules and economic growth. Our results are not influenced by the presence in the sample of three countries enjoying the advantages of a major financial center (UK, US and Switzerland) and two emerging countries (South Korea and Taiwan). Furthermore, eliminating these countries, one by one, leads to the same results. As an illustration, we report the results obtained when Taiwan is excluded from the sample in columns (7) and (8). As an additional robustness check, and only for this purpose, we also include India and Russia one by one in our sample countries (results are reported in columns (1)–(4) of Table 3.3. The results remain unchanged implying that entry of a transforming country like Russia, which has codified its contract law containing default rules only in 1996, does not modify our findings (results are reported in columns (3)–(4) of Table 3.3). Further, including India in our sample countries does not modify results (see results in columns (1) and (2) of Table 3.3). That is, we find again a positive relationship between the default rules indicator and economic growth.

Table 3.3 Other regressions. Dependent variable = growth rate of GDP per capita

	Unbalanced (nine countries)[a]				Unbalanced (eight countries)[b]		Unbalanced (eight countries)[c]			
	β-Convergence if India enters the sample		β-Convergence if Russia enters the sample		β-Convergence on the period 1870–1990		Eq. (3.2)		Eq. (3.4): AR(1)	
	IV-2SLS		IV-2SLS		IV-2SLS		FE-OLS		FE-OLS	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Default rule	0.0133** (0.0065)		0.0231*** (0.0068)		0.0118* (0.0068)		0.0145** (0.0066)		0.0133** (0.0068)	
Nb of contract types		0.0039*** (0.0010)		0.0045*** (0.0010)		0.0034*** (0.0010)		0.0027*** (0.0009)		0.0024*** (0.009)
Log of GDP per capita	−0.0241*** (0.0083)	−0.0337*** (0.0086)	−0.0232** (0.0083)	−0.0318*** (0.0090)	−0.0432*** (0.0159)	−0.0491*** (0.0163)				
Growth rate of GDP pc_{t-1}									0.1257* (0.0707)	0.1197* (0.0703)
Constant	−2.8449*** (0.0083)	−2.7729*** (0.4484)	−2.2826*** (0.083)	−2.2188*** (0.0862)	0.3351*** (0.1245)	0.3656*** (0.1246)	0.0137*** (0.0139)	0.0056*** (0.0145)	−0.4263*** (0.0158)	0.0019 (0.0206)
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R-squared	0.819	0.821	0.680	0.685	0.283	0.290	0.682	0.684	0.687	0.689
Chow test	0.689	0.686	0.619	0.613	0.604	0.601	0.613	0.611	0.607	0.605
Observations	1,149	1,149	1,042	1,042	880	880	1,033	1,033	1,025	1,025
Nb of countries	9	9	9	9	8	8	8	8	8	8

Notes:
FE-OLS fixed effects model tested with least square dummy variable technique, *IV-2SLS* FE tested with instrumental variable (two stage least square) approach, *Nb* number, *Eq.* equation
[a]Unbalanced panel with nine countries (India or Russia included in the sample)
[b]Unbalanced panel with eight countries (see Table 3.1) on the period 1870–1990
[c]Unbalanced panel with eight countries (Table 3.1) based on two alternative specifications: Eqs. (3.2) and (3.4), i.e. AR(1). Robust standard errors are in parenthesis. Instrumented variable: ln(GDP per capita); this endogenous variable is instrumented by using its own first lag (columns 1–6). Country and time dummies are not reported to save space. The values reported for the Chow test are the *p*-values for the null hypothesis of stability of the estimates (breaking date: 1939)
*$p < 0.1$; **$p < 0.005$; ***$p < 0.01$

Table 3.4 Dependent variable = growth rate of GDP per capita

Unbalanced (eight countries)[a]														
	FE-OLS							IV-2SLS						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
ROS***	0.0259 (0.0073)							0.0281 (0.0075)						
CCB, ST, OC, GS***		0.0330 (0.0088)							0.0366 (0.0093)					
IE***			0.0208 (.0081)							0.0226 (0.0083)				
HE***				0.0254 (.0084)							0.0278 (0.0088)			
TBL**					0.0179 (.0073)							0.0199 (0.0075)		
CCA***						0.0369 (.0087)							0.0409 (0.0092)	
PE**							0.0162 (0.0067)							0.0178 (0.0084)
Log of GDP per capita	−0.0174 (0.0080)	−0.0219 (0.0084)	−0.0173 (0.0083)	−0.0188 (0.0085)	−0.0155 (0.0081)	−0.0243 (0.0085)	−0.0136 (0.0078)	−0.0245 (0.0086)	−0.0296 (0.0092)	−0.0247 (0.0090)	−0.0261 (0.0092)	−0.0229 (.0087)	−0.0322 (0.0092)	−0.0208 (0.0083)
Constant	0.1330 (0.0624)	0.1607 (0.0644)	0.1479 (0.0649)	0.1552 (0.0667)	0.1251 (0.0628)	0.1758 (0.0648)	0.1145 (0.0616)	−2.2747 (0.0842)	−2.2324 (0.0877)	−2.2674 (0.0865)	−2.2581 (0.0880)	−2.2829 (0.0845)	−2.2107 (0.0883)	−2.3018 (0.0826)
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R-squared	0.685	0.687	0.685	0.686	0.683	0.688	0.683	0.686	0.687	0.684	0.686	0.683	0.688	0.683
Chow Test	0.609	0.607	0.610	0.609	0.611	0.606	0.612	0.609	0.607	0.610	0.609	0.611	0.606	0.611
Observations	1,033	1,033	1,033	1,033	1,033	1,033	1,033	1,025	1,025	1,025	1,025	1,025	1,025	1,025

Notes: *FE-OLS* fixed effects model tested with least square dummy variable technique, *IV-2SLS* FE tested with instrumental variable (two stage least square) approach, *Nb* number. A dummy variable is associated with each contract type containing default rules. Thus, we have ten dummy variables: *ROS* rental office space, *CCB* contracting for construction a building, *PE* purchasing equipment, *IE* insuring equipment, *HE* hiring employees, *TBL* taking a bank loan, *ST* subcontracting a task, *CCA* contracting with a commercial agent, *OC* obtaining advice from a consultant, *GS* guaranteeing an undertaking by a subsidy

[a]Unbalanced panel with eight countries (see Table 3.1). Robust standard errors are in parenthesis. Country and Time dummies are not reported to save space. The values reported for the Chow test are the *p*-values for the null hypothesis of stability of the estimates on the two subsample periods: 1870–1939 and 1939–2008

*$p < 0.1$; **$p < 0.005$; ***$p < 0.01$

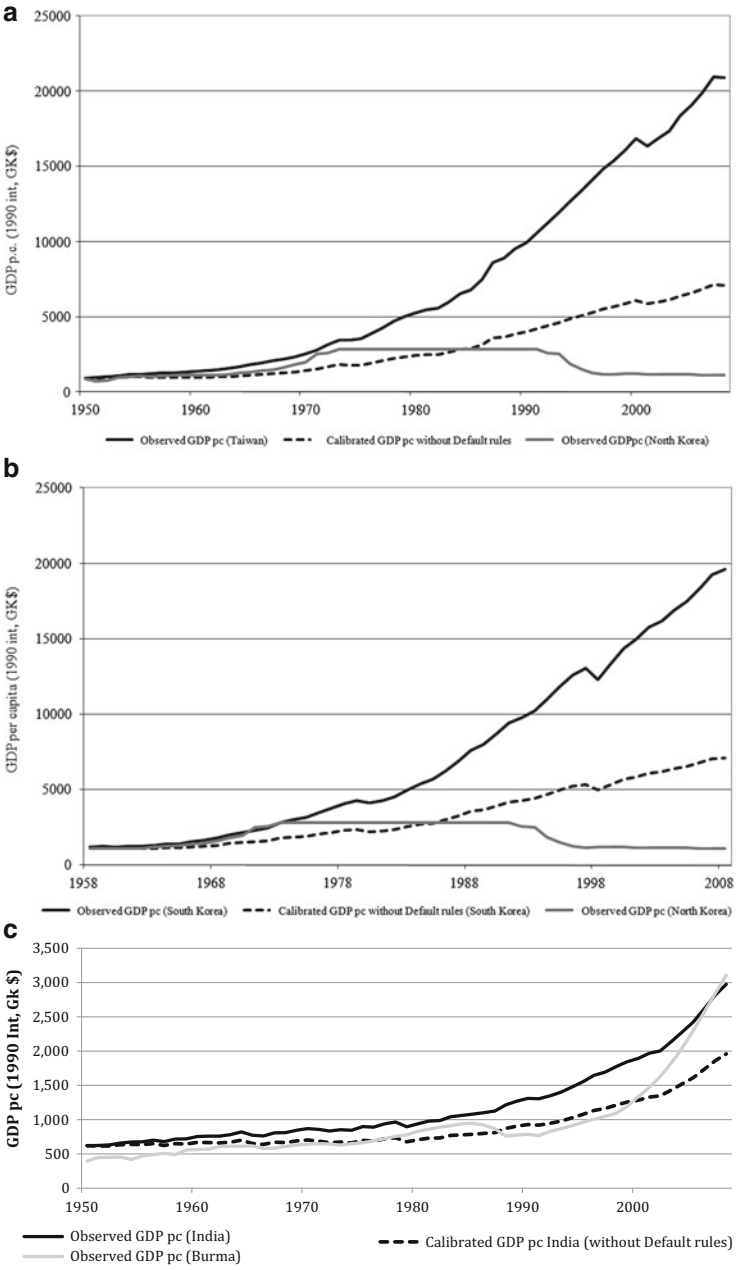

Fig. 3.2 (**a**) Comparison between observed and calibrated GDP per capita of Taiwan, and observed GDP per capita of North Korea (1950–2008). *Source*: authors' calculations. (**b**) Comparison between observed and calibrated GDP per capita of South Korea and observed GDP per capita of North Korea (1958–2008). *Source*: authors' calculations. (**c**) Comparison between observed and calibrated GDP per capita of India, and observed GDP per capita of Burma/Myanmar (1950–2008). *Source*: authors' own calculation

Secondly, given the difficulty of interpreting data for Germany since the unification in 1990, we have conducted a further robustness check (not reported here). We have truncated the sample period in 1990. We have excluded at the same time the incidence of US financial development in the light of Philippon (2008). We have redone the previous estimations for the eight sample countries. The results are reported in columns (5) and (6) of Table 3.3. Again, we found a positive correlation between economic performance and codified default rules. The coefficient for the dummy associated with the presence of default rules equals 1.2 % and is significant at the 10 % level. Here, the coefficient for the number of contract types equals 0.34 and is statistically significant at the 1 % level.

Thirdly, we use alternative specifications. In columns (7)–(10) of Table 3.3, we report the FE-OLS results obtained by estimating the two alternative specifications: Eqs. (3.1) and (3.4), i.e. the AR (1) model. We found again a positive correlation between economic performance and the codified default rules. Thus, our results are not influenced by the model specification. Under all regressions for robustness, the Chow test shows that the model parameters are stable.

Lastly, additionally and as an illustration, we estimate the model (1) for the eight sample countries by taking a default rule indicator for each contract type offering default rules separately. Results are reported in Table 3.4. Again, we find a positive relation between codified default rules and economic performance at contract type level. The Chow test also guarantees the stability of the model parameters since its *p*-value is always greater than 5 %.

In sum, we find that default rules, measured by their presence or absence in codifications of contract law for at least one of the ten economically important contracts or for each contract type or furthermore by the number of economically important contracts types containing such rules, favor economic performance. Whether we use balanced/unbalanced panel, exclude or add some countries or truncate our sample period or use alternative specifications, the result is still robust.

3.3.5 Numerical Illustration

To illustrate the impact of adopting codified default rules on GDP per capita, we simulate a counterfactual scenario showing what would have been the evolution of GDP per capita of Taiwan and South Korea had they not adopted default rules. We compare the two situations with North Korea since the GDP per capita of these countries was similar in the 1950s and North Korea has never adopted default rules as explained in the previous section. Based on the data, the economic performance of Taiwan and South Korea remains greater than that of North Korea. However, based on the regression (4) in Table 3.2, Fig. 3.2a, b shows that, without contract types with default rules, Taiwan's GDP per capita as well as South Korea's GDP per capita would be much less than what we observe. In other words, Fig. 3.2 illustrates that codifying ten contract types with default rules (which is a huge institutional change as explained in Sect. 3.1) multiplies GDP per capita by almost

three in the long run. Furthermore, North Korea could have grown faster than both South Korea during the period 1963–1985 and Taiwan in the period 1953–1985. This scenario confirms the hypothesis that default rules matter for economic performance.

In order to offer a similar illustration in a set of common law countries, we could simulate a counterfactual scenario by comparing the case of India used in our robustness checks in Sect. 3.3.4 with that of Burma. As reported in Sect. 3.2.3.2 the Anglo-Indian Contract Act of 1872 codified four economically important contract types whereas the UK codified only one contract type, the sale of goods, in 1893. Had it not been for the transplant effect, India's economic performance could have been expected to overtake that of the UK even before independence. Burma became part of the British colony of India in 1886 and all Anglo-Indian acts were codified for Burma in the Burma Act of 1898 (Finch and Schmahman 1997). In 1934, Burma became a separate British colony, but the contract law of the Burma code remained in force. In 1947, Burma declared independence and established its own High Court and Supreme Court. But just like India, it continued to apply colonial codified law. In 1962, however, the first military coup abolished the parliament and the two courts of appeal. In 1965 a new "Chief Court" directing all judges to find the law no longer in the common law but in Buddhist law (Southalan 2006). In 1972 a "system of people's justice" replaced the independent judiciary. Prevailing opinion considers that Burma since then was "dislodged from the common law family to the socialist law family" (Huxley 1998). Following the military coup of 1998, a new Judiciary Law of 2000 has reintroduced some degree of independence of the judiciary, but always under the implicit condition that the interests of the military authorities are not touched (Southalan 2006). Hence, at least from 1965 to 2000, we must assume that unlike India, Burma has not applied the default rules for the four contract types codified in the Anglo Indian Contract Act and the Burma code.

Figure 3.2c highlights that without contract types with default rules, India's GDP pc shall be much less than what we observe. Further, Burma should have grown faster than India during the period 1976–1987. Even if the GDP pc in Burma experienced a severe decline in 1987; its trend displays a takeoff since 2000. Accordingly, Burma's GDP pc should have caught up and exceeded the GDP pc for India from 2000. Again, this scenario reinforces our findings that default rules matter for economic performance.

3.4 Conclusion

In this chapter, we have shown that contract theory, which focuses on codified default rules reducing information asymmetries and transaction costs, qualifies LOT's claim that common law is economically superior to civil law. To address this issue properly, we selected a sample of ten of the most important economic contract types and kept track of the number and timing of the codification of default

rules for these contract types between 1804 and 1987 in eight representative countries: France, Germany, Japan, the UK and the US as representative of "legal origins" influencing other countries legal systems, South Korea and Taiwan as high growth countries having voluntarily and autonomously chosen to adopt civil codes in the 1950s as purposefully designed amalgams of domestic legal traditions and borrowed Western patterns, and Switzerland as a prominent case, counterintuitive from LOT's point of view, of a country combining a history of peace, a civil law legal system and the status as a major financial center.

In order to identify the impact of the presence or the absence of codified default rules on economic performance, as measured by per capita GDP growth in prolonged times series between 1870 and 2008, we have performed an extensive econometric evaluation combining the most advanced tools in panel data analysis and more standard techniques. Controlling for time and country fixed effects we have found that codified default rules do favor economic performance across the cleavages of legal origins. But our analysis also reveals that the higher the number of economically important contract types codified with such default rules, the greater the economic effect. This is reflected in the evolution of per capita GDP of the six civil law countries of our sample as compared to the two common law countries. While all of the former have codified all 10 of the economically most important contract types selected, the latter have offered their business communities codified default rules for only 1 (UK) and 3 (US) contract types. We submit that the six civil law countries, which have overtaken the per capita GDP growth of the UK or have emerged on a sustained path of convergence without enjoying the advantages of a financial center, owe part of that performance to their much higher number of codified default rules easing the conclusion of enforceable contracts. Moreover, Switzerland's per capita GDP exceeding that of the UK for eight decades and that of the US for three decades in the inter-war and post-World War II periods invalidates LOT's assumption that civil law is not a favorable environment for the supply of capital to financial markets. We consider these two conclusions as important qualifications of legal origins theory from the point of view of contract theory. While qualifying legal origins theory, our results strongly confirm institutional economics in its core of contract theory.

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Chapter 4
Contract Modification as a *rebus sic stantibus* Solution to the Subprime Crisis

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4.1 Introduction

The preferred levels of analysis of the global discourse on the origins of the subprime crisis appeared to be ethical and epistemological. Bankers saw their morals questioned. Cognitive errors in financial innovation were revealed. The economics discipline recognized its disarray. The debate on the resolution of the crisis focused on public policies: short-term macro-economic policies and specialized regulatory reform of the financial sector to avoid recurrence of a similar crisis in the future. The chosen levels of discourse and policies masked the fact that the subprime crisis was—and remains—a balance sheet crisis of the household and financial sectors, and that further deterioration of balance sheets cannot be effectively prevented without solving issues of private law between the parties of the economic transactions involved. The legal fields concerned are contract law, property law and enforcement law.

We have been arguing since 2009 that comparative lawyers of both civil law and common law countries, as well as scholars interested in the relationship between law and economics, should make a transnational case for solving the subprime crisis on the level of private law in addition to macro-economic remedies and regulatory reform (Schmiegelow 2009b; Schmiegelow and Schmiegelow 2009). We felt that there was no way around relating the cognitive challenges to the economics discipline arising from the subprime crisis to their legal consequences and solutions. We proposed looking at what the philosophy of science has to say about law and economics. We hoped such an exercise would promote readiness for

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compromise; compromise between the parties of mortgage contracts, of sales of mortgage-backed securities (MBS), of settlements between regulators and banks, of debate in the US Congress and, finally, within the US Government, presupposing a view to rapid voluntary correction of invalidated assumptions and to contract modification on the basis of the *rebus sic stantibus* principle.

Most remarkably, leading economists of both neo-classical and Keynesian persuasion (Feldstein 2011; Krugman 2011) did plead strongly for mortgage modification as a crucial method of solving the subprime crisis. The Obama Administration attempted various programs of support for homeowners, unsuccessfully on the legislative level and with mixed results on the level of the executive agencies. The US Congress remained deeply divided ideologically on many points, among others on the issue of whether "predatory lenders" or "predatory borrowers" had caused the crisis, but in the end adopted the Dodd-Frank Wall Street Reform and Consumer Protection Act (US Congress 2010). This is considered to be the most ambitious regulatory reform since the Great Depression with the aim of preventing recurrence of similar crises in the future.

In stark contrast to the soul-searching debate in the economics discipline on the origin and the resolution of the crisis (Shiller 2005, 2008; Akerlof and Shiller 2009; Samuelson 2009; Spence 2009; Summers 2009; Krugman 2008, 2011; Feldstein 2011; Admati and Hellwig 2013), contributions from the American legal profession were conspicuously rare. Kenneth Dam, the eminent scholar of comparative law, wrote an eloquent working paper on issues of financial regulation from international and comparative perspectives, noting that European banks eagerly participated in the subprime securitization through off-balance sheet entities and used even more leverage in doing so than US banks (Dam 2010). New York Attorney General Eric Schneiderhan gained media prominence by prosecuting banks for defrauding investors who had bought MBS (New York Times Editorial October 2, 2012). So did Judge Jed Rakoff of the Federal District Court for the Southern District of Manhattan by rejecting a settlement between the US Securities and Exchange Commission (SEC) and Citigroup, which allowed the bank "neither to admit, nor to deny allegations" of securities fraud in selling MBS (New York Times November 28, 2011). Among legal scholars specializing in bankruptcy law, Adam Levitin, Assistant Professor at Georgetown University Law School, was a rather lonely, but sharply critical voice on the mortgage lending, securitization and foreclosure practices of leading American banks (Levitin 2009).

That leading Wall Street law firms remained silent may be understandable, since most of them were professionally involved in the securitization process of MBS. That LOT's authors remained silent—as far as we can see—is more significant, since, as mentioned in Chap. 3, at least two of them, Andrei Shleifer and Robert Vishny, have been considered pioneers of behavioral finance and should therefore be concerned by how to restore the trust between lenders, borrowers, securitizing banks and MBS investors, which unraveled so completely in the subprime crisis. This trust, they had posited, grows in common law countries rather than in civil law countries. Now that the trust has broken down, it is time to mobilize the resources of both common law and civil law to repair it.

Meanwhile, the balance sheets of banks remain impaired in one way or the other by the "legacy" of toxic securities. This legacy may have been neutralized in various ways in different countries, transferred to "bad banks", bought by the Federal Reserve, or allowed to not be considered in stress tests of banks in the US. But, of course, it has not gone away and remains to be settled in some more or less distant future. In the mean time, it continues to be in the joint interest of all parties concerned to maintain as much value as possible in homes, mortgages and MBS and the least costly way to do so remains, as we continue to argue, contract modification using the *rebus sic stantibus* principle.

The narratives of the subprime crisis reflect a cognitive reversal invalidating assumptions basic to millions of mortgage contracts and their securitization (Sect. 4.2). The appropriate legal consequence of such a situation, and a functional contribution to solving the crisis at the same time, would be the application of the *rebus sic stantibus* principle, i.e. the adjustment of contracts to supervening events changing vital circumstances assumed to prevail at the time of the parties' agreement. As a legal reflex to a cognitive crisis, *rebus sic stantibus* should be understood as part of the process of conjectures and refutations in Karl Popper's critical rationalism. As an instrument with roots in Roman law, which has been recognized since the Middle Ages in international law, but under various modern doctrines also applies to private contracts in both common law and civil law countries, it is a time-tested legal frame for reestablishing Hayekian spontaneous order after the crisis (Sect. 4.3).

It matters little whether a *rebus sic stantibus* solution to the subprime crisis is sought as judicial relief or by legislation. While LOT attributes a greater adaptive quality to case law, as in the common law, than to legislated codes, as in civil law, a closer look at legal philosophy, comparative law, and, not least, American legal and economic history reveals that both common law countries and civil law countries increasingly rely on the functional interaction between legislative and judicial processes. The only judicial relief for changed circumstances offered by English common law, i.e. complete contract discharge would be clearly dysfunctional in cases such as the subprime crisis (Sect. 4.4).

Aluminum Co. of America vs. Essex Group is an important American precedent of contract modification in case of changed circumstances. Since in that case the supervening event was also an economic crisis invalidating long-held price assumptions, namely the two massive oil price rises in the 1970s the ruling would appear unquestionably relevant. However, as in Alcoa's case the "changed circumstance" was a rise in the production costs of a firm that might have hedged against such an event, the ruling has not met with unanimous approval in American jurisprudence. So far, Germany's hyperinflation from 1919 to 1923 appears to be the only economic crisis that effectively triggered an adaptive judicial response to change in macro-economic circumstances. The landmark ruling of the German Supreme Court, the Reichsgericht (Germany's supreme court (court of last resort) of ordinary jurisdiction in all matters of civil and criminal law from 1879 to 1945 (RG)), of February 3, 1923 applied a modernized form of the Roman law *rebus sic stantibus* principle to protect a creditor against unforeseeable hyperinflation practically

wiping out his claim. Expecting the parties of a contract to renegotiate it in good faith in such a supervening event, the ruling may serve as a functional pattern for contract modification in an economic crisis (Entscheidungssammlungen des Reichsgerichts in Zivilsachen 103, 328). While the revaluation of debt was the RG's solution in a case of hyperinflation, its logic would require a devaluation of the debt, or at least of the debt service, in a case of deflation (Sect. 4.5).

The "basic assumption" of a future rise in US house prices beyond historical levels, i.e. house price inflation, was a vital circumstance for subprime mortgage contracts (Sect. 4.6). The massive house price deflation since 2007 was the supervening event calling for downward modification of mortgage debt (Sect. 4.7). Modification of more than 15 million mortgage contracts and the re-pricing of related securities is a major management challenge, the more so as Neil Barofsky, the Special Inspector General of the Troubled Asset Relief Program (TARP) called for the supervised screening of each mortgage slice packaged in each asset-backed security to prevent conflicts of interest or fraud. The American recording system, which has been found by most recent econometric analysis to be more costly and time-consuming than public registries existing in other major countries, may constitute an additional impediment to rapid crisis resolution (Sect. 4.8).

However, as a "balance sheet recession", the subprime crisis calls for rapid damage control. It is comparable to the Japanese deflation after the bursting of the bubble of the late 1980s in 1991, only on a much larger scale and with global effects. To avoid the pattern of Japan's "lost decade" on a global scale, cognitive, legislative and judicial progress towards protecting the balance sheets of the household and financial sectors against further deterioration remains urgent (Sect. 4.9). Pending further legislative, executive or judicial solutions in the US, we propose a notional application of *rebus sic stantibus* wherever possible, and more particularly in re-pricing of "toxic assets" burdening the balance sheets of banks or of institutions having relieved them of this burden for ring fencing purposes, such as for bad banks and central banks. It would be in the financial industry's own best interest to rebuild Hayekian spontaneous order by simultaneously initiating processes of contract modification and balance sheet adjustment, the latter anticipating the former and the former serving as feed-back loop for the latter. The sooner this happens, and the lower the levels at which banks can crystallize losses, the easier it will be for them to rebuild capital adequate for the resumption of their function of financial intermediation (Sect. 4.10).

4.2 The Subprime Crisis as a Cognitive Reversal

The narratives of the US subprime crisis shatter vital assumptions about economic transactions prevalent both in mainstream economics and in financial markets. From inside the banking sector, Stephen Green, then Chairman of HSBC, blamed the "arrogance and greed" of banks that "nearly destroyed the world economic system" (Green 2009, at 1). Paul Samuelson, the educator of generations of

economists, castigated the securitization of subprime mortgages in asset-back securities (ABS) and their insurance by credit default swaps (CDS)—until recently considered to be products of financial innovation—as "fiendish Frankenstein monsters" created by "quants" on Wall Street, "some of them by people like me" (Samuelson 2009). Lawrence Summers spoke of a "fatal blow" to the theory of self-regulating markets (Summers 2009). Angela Merkel (2009) and Sarkozy (2009) saw the sudden ideological turnaround from deregulation to re-regulation as vindications of Germany's social market economy or France's state-guided economy respectively, masking fundamental differences between Germany's ordo-liberal free market philosophy (Blum 1969; Streit 1992) and France's traditionally Colbertist policy pattern (Schmiegelow and Schmiegelow 1975). Gordon Brown, the former promoter of the City of London's light touch, called for "morals in markets". Paul Krugman pleaded for massive fiscal expansion in all major economies, while Peer Steinbrück, Germany's fiscally conservative social democrat former Minister of Finance, rejected US and UK stimuli as "crass Keynesianism", in turn provoking Krugman to "crass warfare" (Krugman 2008) in economic policy debate. Each of these narratives may reflect part of the truth; none can offer a solution at the root of the crisis in the American real estate and financial sectors.

The global crisis discourse ignores the fact that there can be no sustainable solution to the subprime crisis until issues of contract law, property law, and enforcement law in the US are resolved. These issues are the first link of a chain of causation from successive waves of foreclosures of delinquent mortgages across the US to a full-blown global economic crisis. The chain runs through the persistent stalemate between "sell side" and "buy side" of Wall Street's MBS market, the impossibility to assess fair values of such securities, the reluctance of American and European banks to clean their balance sheets of such "toxic assets" for fear of exposing the capital shortfall resulting from write-downs, the failure of such banks to assume their function of financial intermediation, the credit crunch for consumers and small and medium size enterprises, the self-elimination of the US as consumer of last resort of the world economy, the dramatically shrinking exports of surplus countries like Germany, China and Japan, rising unemployment and massive fiscal stimuli in all large economies, ending in public debt at precarious levels, and contributing to the Euro zone sovereign debt crisis. The global economic and social cost of unresolved legal issues in the American real estate and financial sectors is mounting. The health of the American and the European banking sectors remains fragile, the intermittent recovery of a small number of leading American banks outperforming the sector notwithstanding. The world economy depends on either a rapid realization of the enlightened self-interest of the financial industry or on America's—much more lengthy and costly—legal process rising to the occasion.

4.3 How *rebus sic stantibus* Could Function in the Current Crisis

Like any cognitive reversal involving the refutation of flawed conjectures by empirical evidence, the subprime crisis calls for efforts in critical rationalism on both cognitive levels and levels of public policy and individual practice. That the artificial maintenance of conjectures refuted by empirical evidence is not only bad science but can be extremely costly to the economy and society needs no further explanation since Karl Popper's philosophy of science became the leading methodology of natural science and his theory of society the model of open societies. The standard references are Popper's works on scientific methodology (1934/1959), on the relation between philosophical problems and science (1963), and on evolutionary rationalism and societal organization (1945). Friedrich von Hayek applied Popper's critical rationalism to economics, which meant to question the constructivist rationalism of some of the models of neo-classical price theory, general equilibrium theory and rational expectations theory, as they appeared immunized against refutation by empirical market developments, including market failures such as the Great Depression (von Hayek 1952 particularly p. 25; von Hayek 1973, p. 46; von Hayek 1978, p. 23). Both more modest and more rigorous than economic model builders in the constructivist mold, Hayek considered market prices as the result of a "spontaneous order" arising from the meeting of subjective valuations of market participants (von Hayek 1996). His attack on "scientism" in his 1974 Nobel lecture, if reread today, sounds as if he had foreknowledge of Paul Samuelson's narrative of "fiendish Frankenstein monsters" engineering the subprime crisis.

Letting the chain of causation summarized in Sect. 4.1 continue to run its course without adjusting contracts and balance sheets to the refutation of flawed assumptions about future house prices by a supervening financial crisis would not only be like maintaining the Ptolemaic doctrine of geo-centrism against Galileo's heliocentric evidence, but the final reckoning would destroy economic value all the more, the later it comes. Rapid adjustment of contracts and balance sheets would lift the persisting cognitive fog obscuring the conditions for an early and a sustained recovery. It would involve limited and calculable write-downs as well as reduced recapitalization needs in the financial sector, since modified mortgage contracts would still preserve the major part of the principal and generate considerable, though reduced, interest revenue. The impact on the value of MBS would be measurable and moderate compared to the risk of complete write-downs in the absence of timely adjustment.

Voluntary contract modification based on efforts at critical rationalism by all parties involved would be a paradigm of Hayek's spontaneous order. As Hayek has recognized, spontaneous order in markets relies on general rules of law offering orientation to the behavior of market participants (von Hayek 1973). As opposed to Richard Posner's positivist approach to economic analysis of law (Posner 2003), Hayek does not analyze law as a dependent variable of rational expectations in

efficient markets, but, inversely, markets as depending on the rule of law within a larger social order (Mestmäcker 2007). Although the law does respond to change in economic and social development, it does so in an evolutionary cognitive process as "new situations, in which the established rules are not adequate, will constantly arise, requiring the formulation of new rules by the judges" (von Hayek 1973, Vol. 1, p. 119).

A perfect illustration of the difference of Posners' positivist approach and Hayek's evolutionary legal philosophy is the difference between the "efficient breach" and the "*rebus sic stantibus*" doctrines in contract law. Posner is the leading proponent of the "efficient breach" hypothesis, arguing that a party should be allowed to breach a contract and pay damages, if doing so would allow him to obtain greater profit by contracting with a third party. The efficiency requirement would be satisfied if the damages paid in compensation for the breach would leave the promisee in as good an economic position as he would have occupied had performance been rendered (Posner 1986). Posner believes the common law inherently legitimizes such efficiency seeking. A closer look at English law reveals, however, that it does not condone the discretionary substitution of a contractual right by a mere remedy for breach of contract (Friedman 1989). Contract law would be no longer a rule of law offering reliable orientation to all market participants if any one of any pair of contracting parties could "breach" it "efficiently" at any time at his discretion.

The *rebus sic stantibus* doctrine, on the contrary, cannot be invoked to obtain contract discharge or modification at any time by any one contracting party seeking higher rewards elsewhere, but only in cases of a change in vital circumstances by supervening events independent of the discretion of the parties. To be sure, the *rebus sic stantibus* principle will also offer greater economic efficiency than impractical contract enforcement, if the supervening event invalidates basic assumptions of the contracting parties about market conditions. But at the same time, it is a general principle of law resulting from an evolutionary cognitive process of the Hayekian type beginning in Roman jurisprudence with Seneca and Cicero (Zimmerman 1990) and finding its most modern expressions in the contract law of both common law and civil law countries. In this and the following sections, we argue that the *rebus sic stantibus* principle offers not only an immediate crash-barrier in the crisis, but also orientation for restoring spontaneous order after the crisis.

Significantly, the Obama Administration has recognized the problem of foreclosures at the beginning of the chain of causation of the subprime crisis in two initiatives, the "Helping Families Save Their Homes in Bankruptcy" Bill of January 2009 in the US Congress (US House of Representatives 2009) and the "Making Homes Affordable Program" of the Administration initiated in March 2009 (US Department of the Treasury 2009). To be sure, these initiatives were ostensibly intended more as palliatives to symptoms of social hardship, while crisis resolution was sought in macro-economic policies and regulatory reform. But, unknowingly, the two initiatives already contained the cognitive seeds of what could be part of an effective cure of the economic illness: mortgage modification. Unfortunately,

against the financial industry's own best interests, a lobbying campaign by the US banking sector stopped the first initiative in its tracks,[1] and the reluctance of mortgage servicers to respond to the offered public incentive of $1.000 per avoided foreclosure deprived the second of any significant effect.[2] By September 2009, there was an inventory of delinquent or foreclosed mortgages of some seven million houses.[3]

While foreclosures are part of the chain of crisis causation, their avoidance alone will not solve the threat of severe balance sheet deterioration—visible or hidden by exemptions from accounting rules—of both the financial and the household sectors, which characterizes the crisis. To be both fair and effective, contract modification would have to be made available to all relevant homeowners before they default on their mortgage. The number of homes in the US that are "underwater" (in negative equity), i.e. facing the prospect of mortgage delinquency and foreclosure either actually or potentially, as the value of the home covers reduced percentages of the principal of the mortgage, was 15 million in July 2009,[4] more than double the actual inventory of mortgages already delinquent or foreclosed. There is thus a groundswell of potential supply in the US real estate market that has not yet reached the surface, but that will depress house prices, and hence balance sheets, as soon as it does. The offer of contract modification to subprime mortgage debtors could break that groundswell. The aggregate results of such contract modifications would inform write-downs in the balance sheets of lenders, the re-pricing of MBS and CDO and the recalculation of bonuses indexed to performance. They would stabilize the markets at much higher levels than what will have to be expected if the vicious cycles of balance sheet deterioration go on unchecked.

In legal terms, the application of the *rebus sic stantibus* principle to the subprime crisis would mean to take the cognitive and economic reversals referred to in Sect. 4.1 seriously, as a change in vital circumstances. All parties involved in the household and financial sectors should anticipate that, in the fullness of time, court rulings or new statutes will eventually lead to adjustments of contracts so that no individual contracting party, nor the taxpayer, would have to bear an unfair share of the as yet unquantifiable losses. The problem is that, given the continuing risks resulting from the legacies of the subprime crisis for the economies of the affected countries, they do not have the "fullness" of time. The sooner they begin understanding the *rebus sic stantibus* rule as a way to unfreeze the stalemate of untenable claims, the better the outlook for their eventual balance sheets.

The "greed" narrative of the subprime crisis puts the blame on "predatory lending" by banks to low-income homeowners. Indeed, American lenders and brokers eagerly collected fees even on "Ninja loans" (no income, no job, no (questions) asked) amounting to more than 100 % of the value of the home at the

[1] Ailing banks still wield influence. *International Herald Tribune* 15, 6 June 2009.

[2] Early hope for mortgage help recedes, *International Herald Tribune* 17, 6 July 2009.

[3] Authers (2009).

[4] Nocera (2009).

time of the contract (Soros 2008). "Teasing rates" of about 2 % were offered for the first few years, thereafter rising to about 8 %. The implicit assumption of these mortgage contracts was that house prices would continue to rise beyond historical patterns, making it easy for subprime owners to reschedule their debt. Millions of them became an easy prey to such temptation.

Not so, said former US Senator Phil Gramm,[5] this was "predatory borrowing". The homebuyers should have read their mortgage contract and been aware of the limitations of their income and assets. In such instances, the sanctity of contracts must be respected, a common law judge of the classical tradition would rule. And any lawyer in European or Asian civil law countries would tend to agree on first instinct, mindful of the Roman law rule pacta sunt servanda, enshrined in all modern civil codes.

But wasn't it immoral, implies the "moral narrative", to expose the inexperienced borrower to the risk of foreclosure, should home prices and wages not continue their assumed upward path? Wasn't the packaging of such mortgages in MBS and their sale to institutional investors a breach of trust? Civil law codes such as France, Germany's, and Japan's, as well as the Uniform Commercial Codes of the States of the US (UCC) have answers to these questions. They moderate the "animal spirits" (Akerlof and Shiller 2009)[6] of market participants by general clauses. These clauses require contracting parties to negotiate and implement the contract in good faith. And good faith, courts in most civil law countries and the US recognize today, also requires contracting parties to adjust the contract when supervening events result in changes of vital circumstances they assumed to be present at the time of the contract or in the future.

This concretization of the *rebus sic stantibus* principle as a case of the codified rule of good faith originated in Germany in the 1920s under the term *Wegfall der Geschäftsgrundlage* (invalidation of the basis of transaction) in reaction to severe post World War I disruptions of the German economy. With Paul Oertmann's monograph *Die Geschäftsgrundlage*: *ein neuer Rechtsbegriff* (The Basis of Transaction: a New Legal Concept) of 1921 serving as a long overdue jurisprudential pathfinder, the judge-made doctrine took off just 1 year later. The landmark case was one of severe inflation between contract date and due date. In 1923, the RG, following Oertmann, ruled that contract modification, in this case revaluation of the debt, was the only solution in accordance with §242, the general clause of good faith in Germany's *Bürgerliches Gesetzbuch* (Civil Law Code, hereafter *BGB*) (RG 103, 328). In France, a similar line of reasoning under the doctrine of *impré vision* (want of foresight) was initiated by the Cour de Cassation (Court of Cassation) in the 1990s as part of a more comprehensive reorientation of French contract law towards standards of good faith. Leading cases are *Cass com 3 November 1992*, *Bull civ IV no.338*, *Cass com 24 November 1998*, *Bull civ IV No. 227* (Fauvarque-Cosson 2013).

[5] A convinced deregulator, even now. *International Herald Tribune* 13, 18 November, 2008.

[6] See also Shiller (2009), at 9.

In what Glenn calls Asia's legal tradition, the doctrine of *rebus sic stantibus* finds easier acceptance than the Roman law rule *pacta sunt servanda* (Glenn 2004). In Japan, adjustment to change of vital circumstances (*jijou henkou*) is not only categorized as a requirement of good faith, enshrined, most prominently among all Civil Codes, in Art. 1 of the Japanese Civil Code of 1897 (Sawada 1968; Iijima 1994; Kubo 1999), but also considered as a necessary condition of openness of a dynamic market economy and business environment to pragmatic adaptation. There are cultural interpretations of Japanese pragmatism (Haley 1998), but its functional qualities in Japan's modern economic development are just as easily analyzed in terms of American philosophical pragmatism and of critical rationalism in the philosophy of science (Schmiegelow and Schmiegelow 1989).

Rebus sic stantibus also had an important place in China's legal doctrine since the founding of the Republic in 1912 (Wang 1997). The Chinese term *shiqing biangeng* uses the same Chinese characters as the Japanese term *jijou henkou*. Adjustment of contracts to changed circumstances was explicitly included in various drafts of China's new Contract Law (Liu 2008). The final version promulgated in 1999, which was decisively influenced by UNIDROIT principles, instead followed the legal technique of major civil codes by relying on the general clause of good faith (§4), which opens the way for judicial recognition of changed circumstances (Liu 2008). Indeed, in February 2009, the Supreme People's Court of China issued guidelines on the interpretation of the Contract Law in cases of changed circumstances in general (Fashi No. 5 of February 9, 2009, Section 26), and as early as July 7, 2009, on circumstances changed as a result of the financial crisis (Fafa No. 40 of July 7, 2009). Most significantly, it favors contract modification negotiated between the parties over complete discharge from the contract, remarkably reminiscent of *RG 103*, *328* in its landmark ruling of 1922, which we will discuss in more detail in Sect. 4.4.

English and American lawyers have been familiar with the *clausula rebus sic stantibus* in international law for centuries. Most notably, one of the earliest invocations of the scholastic version of the doctrine was by the protestant Queen Elizabeth I of England against the Netherlands (Oppenheim and Lauterpacht 1954, at 939(n)). Today, the common law, too, recognizes supervening events resulting in changed circumstances. Lawyers advising firms on mergers and acquisitions, for example, frequently include a "material adverse change" clause in the agreement, which allows their clients to get out of the deal, if the target company's performance deteriorates after the agreement was signed. Invoking the clause usually leads to litigation ending the agreement or prompting parties to renegotiate the terms of the agreement. In the case of the take-over of Merrill Lynch by Bank of America in 2008, the risk of such an invocation may have been on former Treasury Secretary Henry Paulson's and Federal Reserve Chairman Ben Bernanke's minds when they supported the take-over as a "rescue".[7]

[7] Examining the Anger on Merrill Deal. *International Herald Tribune* 9, July 18, 2009.

In cases of contracts without such clauses, common law courts consider whether there are conditions implied in law as default rules to fill the gap in the language of the contract. English courts do so when the changed circumstance would make the contractual performance "fundamentally different". American courts speak of "basic assumptions" not obtained, making performance "impractical". Traditionally, however, common law courts have not seen it as within their power to adapt or modify contracts to changed circumstances. The only legal consequence they have recognized within narrow bounds is complete discharge of the contract. English courts developed, and American courts followed, the doctrine of "frustration of purpose", under which a party may be discharged from the contract if the other party's return performance has become so worthless as to frustrate the first party's purpose in making the contract (Farnsworth 2006). The leading cases are *Taylor v. Caldwell* (1863) 3 B&S 826 and *Krell v. Henry* (1903) 2 KB 740; the doctrine is reflected in §261 of Restatement 2nd.

In the US, however, the adoption of the UCC in all US States in the 1950s brought a significant enlargement of the English tradition of narrowly focusing on explicit or implied terms of the contract towards a more substantive reasoning including moral, economic, political or institutional considerations (Atiyah and Summers 1987). The most important institutional reflection of this opening was the general clause of good faith in 1-103 UCC, reconfirmed by §205 Restatement 2nd. Arguably, this moved the US to a course of closer convergence with French, German and Japanese civil law than with English common law. Whereas general clauses of good faith are considered to be distinctive features of all major civil codes, English courts have been "adamant in refusing such a restraint on the behavior of a contracting party" (Farnsworth 2006, at 919).

Hence, today, the US appears institutionally much better prepared than England to cope with an invalidation of basic assumptions as in the narratives of the subprime crisis. More particularly, some voices in common law jurisprudence (Speidel 1982; Farnsworth 1990; Nottage 2008), §272 of Restatement 2nd and at least one major court ruling, *Aluminum Co. of America vs. Essex Group* (1980) 499 Federal Supplement 53, have recognized that contract modification rather than contract discharge may be required by the standard of good faith, especially in cases of long-term contracts.

As must be obvious to any American mortgage broker, lender and borrower, any "quant" on Wall Street, any originator of an MBS, and any buyer of such securities, the "basic assumption" of rising American house prices beyond historical levels did not hold true. The purpose of making homes affordable to subprime owners thanks to such price rises was clearly frustrated by the failure of the mathematical models on which the marketing and the securitization of subprime mortgages was based. It must be equally obvious to all parties involved however, that the complete discharge of mortgage contracts would completely cancel whatever value delinquent mortgages might still represent for lenders and borrowers. MBS would be devalued much more than necessary by such a complete disappearance of the subprime portion of their coverage.

Clearly, the solution of classic English common law, if applied across-the-board to the subprime situation, would be severely dysfunctional from an economic point of view. Depending on individual cases, the complete discharge of the borrowers from their mortgage obligations might turn out as an unjustified windfall rather than an ethically and functionally appropriate protection against an unfair burden from changed circumstances. The winding up of balances of paid out principal and past debt service for millions of mortgages constitutes an enormous management burden at incalculable transaction cost and full of legal risk for lenders and borrowers alike. For lenders, MBS originators, and MBS buyers alike, complete contract discharge would constitute an immediate book loss of the entire securitized principal and capitalized interest. Banks with MBS on their balance sheets would have to write down the affected portions of mortgage packages completely and immediately. They would be particularly threatened by the "perverse incentive" of CDS. CDS are tradable derivatives that normally function as default insurance for debt. If a borrower defaults, the protection buyer receives compensation from the seller. But CDS may also attract buyers simply seeking profit by bearish bets against banks seeming to come within reach of conceivable default by exposure to troubled MBS.

MBS debt would turn from merely "toxic" to "lethal" for many banks still protected by special exemptions from fair value accounting rules embellishing balance sheets in the US, or "bad bank" regimes in Germany. In fact the explicit reason of these exemptions, i.e. to buy time until present dysfunctional market conditions become normal again,[8] would have lost its "raison d'être". As soon as common law precedents of complete contract discharge were applied to subprime mortgage contracts, there would be no way of maintaining any benefit of the doubt as concerns the valuation. The complete destruction of the value for lenders and MBS holders would have to be acknowledged. The impact on credit markets, stock markets, and real economies depending on financial intermediation would be catastrophic. Demand for public bailouts and recapitalization of banks as well as fiscal stimuli would immediately soar beyond levels making any economic sense.

Of course, we can assume that the authors of LOT never looked at the frustration of purpose rule of judge-made law in England and Wales, the mother country of the common law. But one may just wonder how they would consider the disastrous economic consequences of complete contract discharge in a case such as the subprime crisis. Clearly, if there are significant differences in the economic quality of legal origins, as LOT assumes (La Porta et al. 1997, 1998, 2008), we find them not only between common law and civil law, but also, and significantly so, between the judge-made or codified laws of the two leading common law countries.

[8] US Congress helped banks defang key accounting rule: The payoff is likely to be fatter bottom lines in the second quarter. *Wall Street Journal*, 4 June 2009, 14.

4.4 A Legislative or a Judge-Made Solution?

Obviously, contract modification is overwhelmingly preferable to contract discharge in such a situation. The two initiatives of the Obama Administration already mentioned in Sect. 4.2 clearly reflect that preference on the level of analysis of economic policy. Had the Administration and the Congress majority followed the cognitive path of that preference to the legal level of analysis, it might have gone to the heart of the matter and endowed common law judges by statute with the power of giving parties the choice of modifying contracts. That would have saved the fiscal cost of the $1,000 subsidy per avoided foreclosure to the mortgage service industry in the Administration's "Making Homes Affordable Program".

It would also have helped reopening the "adaptability channel" of American law, which, according to LOT (La Porta et al. 1999, 2008), is the distinctive advantage of common law as compared to civil law. LOT proposes two channels linking legal infrastructure and substantive content of rules: an "adaptability channel" distinguishing common law as inherently more "adaptive" than civil law, thanks to its reliance on judicial rule-making (Beck et al. 2003), and a "political channel" marking a "regulatory bias" in civil law with greater opportunities for inefficient rent-seeking (Rajan and Zingales 2003).

In fact, from a comparative and historical perspective, quite the opposite distinction appears between the two great legal families, at least as far as adaptation to vital change in circumstances is concerned. With Paul Oertmann's monograph of 1921 and *RG 103*, *328* of February 1923, Germany's jurisprudence and judiciary reacted with remarkable speed to counter change in vital circumstances caused in "political channels", as it were, i.e. World War I, war reparations imposed on Germany beyond its economic capacities, the dysfunctional recourse of the German government of the time to printing money and the resulting hyperinflation from 1919 to 1923. By ruling that debt had to be revalued in line with hyper-inflation between contract date and due date, the RG required parties to consider maintaining the functional purpose of the contract rather than allowing inflation to do what it always does to the dismay of economists, wipe out the debt.

By the standard of today's new discipline of law and economics, the ruling stood out by its adaptive quality, putting an effective break on inefficient rent seeking by debtors intent on taking advantage of inflation. Moreover, the ruling became case law setting a precedent in the best "common law" mode, as it were. For, contrary to the Austrian civil code, and just like the French civil code, the drafters of the German BGB of 1900 had rejected the inclusion of an explicit clause of *rebus sic stantibus* into the code. Their emphasis was on private autonomy and the sanctity of contracts, although within the bounds of the general clause of good faith. *RG 103*, *328* is one of the numerous early departures from positivist application of the letter of the code demonstrating the growing importance of judge-made law in civil law countries. Just like *RG 52*, *18* in 1902 on breach of contract by collateral negligence and RG 78, 23 in 1911 on *culpa in contrahendo* (fault in contracting), it was the beginning of a continuous line of judge-made integrations of general principles of

law into German law, continued postwar by the *Bundesgerichtshof* (Federal Court of Justice) (BGH) and finally, after 80 years, in 2002, codified as §313 BGB as part of the reform of the law of obligations (Honsell 2008).

While *RG 103*, *328* was an adaptive response of case law to change of circumstances by Germany's hyperinflation of the 1920s, the US made history by vigorous legislative and executive responses to the deflation of the 1930s. Inversely, there does not seem to be a history of contributions from American or English common law to frustrations of purpose by the Great Depression. On the contrary, as related by historian James MacGregor Burns (Burns 2009), the US Supreme Court, at the time a bastion of conservative economic thought, attempted to impede the implementation of the New Deal by striking down more than a dozen federal and state laws, prompting Franklin D. Roosevelt's controversial and failed proposal to "pack the court" by enabling him to name up to six new judges.

Hence, there is a counterintuitive history of interaction between the economy and the law in times of economic crisis that merits the attention of the discipline of law and economics. The "adaptability channel" reveals judge-made law in a civil law country responding to hyperinflation by filling gaps in the civil code, while the "political channel" shows legislation in a common law country responding functionally to deflation against judicial resistance. The history is less paradoxical, though, than it may appear from LOT's point of view. The two leading thinkers of the twentieth century on the foundations of an open society already mentioned in Sect. 4.2, Popper and Hayek, have indicated ways to resolve the paradox long ago.

Sharing the insight of the fallibility of human cognition both in natural and human sciences, and hence, a deep skepticism of economic models and political doctrines projecting untenable ambitions of scientific certainty, both were convinced that law had to play a crucial role in developing and maintaining liberal democracy and free markets. Popper's path-breaking wartime treatise *The Open Society and its Enemies* (Popper 1945) and Hayek's *Law*, *Legislation and Liberty* (von Hayek 1973) appeared at a time when economic doctrine in the US was oblivious to law, and lament about the lack of a theory on the role of law in economic development widespread among American scholars (Trubek and Galanter 1974). They were philosophical precursors both of the "ordoliberal" policies that shaped Germany's postwar renewal and of the new institutional economics which made its breakthrough in 1991 and 1993, when Ronald Coase and Douglass North received the Nobel Price for their research on how legally binding contracts (Coase 1988) and, more generally, a reliable legal framework for markets (North 1990), rather than impeding business, in fact reduce economic transaction costs (Schmiegelow 2006, 2009a, b).

Scholars quoting Hayek as a reference for assumptions of differences in economic philosophy between the US and Continental Europe might be interested in knowing that he actually is one of the important philosophical links between Germany and the US. Hayek returned from London to Freiburg in 1948 to join the group led by economist Walther Eucken and the civil law scholar Franz Böhm to elaborate the body of thought that later became known as the "Social Market Economy". They were by no means a monolithic group. Eucken and Böhm stressed the importance of a strong state able to impose anti-trust rules as a departure from the rule of cartels in

Table 4.1 What does the theory of science tell us about law and economics?

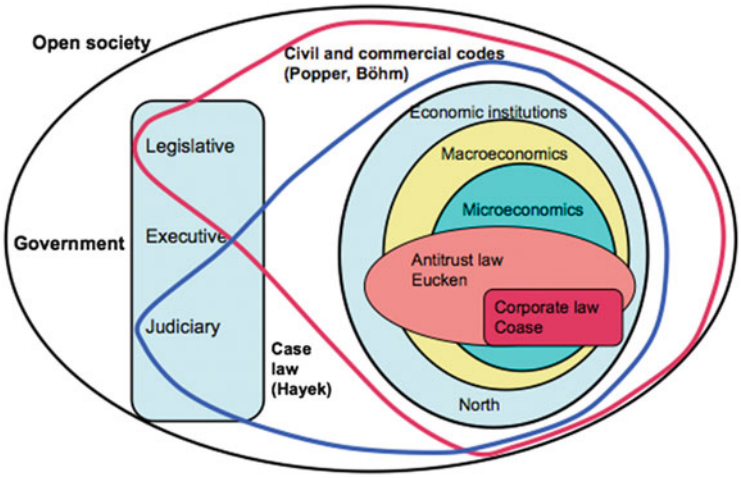
World view	Mechanistic	Recognizing scientific uncertainty
Founders	Isaac Newton	Albert Einstein, Werner Heisenberg, Karl Popper, Friedrich von Hayek
Physics	Law of gravity determining mind and matter	Relativity theory, scientific uncertainty, fallibility of human cognition, logic of scientific discovery: conjectures and refutations (Popper)
Economy and society	General equilibrium theory	Subjective perception of economic value (Methodological Individualism, Hayek), Analysis of market failure (Hayek), Theory of the "Open Society" (Popper)
Law and economics	Laisser-faire, General equilibrium in the absence of laws, Regulation perceived as impediment to business (Legal origins Theory, World Bank-IFC Doing Business Reports)	"Ordoliberalism" (Hayek, Walter Eucken, Franz Böhm et al.) in Germany, Strategic pragmatism in Japan, Institutional economics: laws reduce transaction costs (Ronald Coase, Douglass North) Behavioral economics

Source: Authors' own compilation

prewar Germany's economy (Böhm 1948; Eucken 1949). Hayek showed more leniency towards cartels, but still maintained that a legal "order" was an essential component of liberty. While applauded by libertarian economists for his determined stand against centrally planned economies (von Hayek 1944), he rejected laissez-faire capitalism in equally unequivocal terms: "probably nothing has done so much harm to the liberal cause as the wooden insistence of some liberals on certain rules of thumb, above all of the principle of laissez-faire capitalism" (von Hayek 1960, at 502). He spelled out that the government has a role to play in the economy, particularly so through the monetary system, work-hours regulation, social welfare, and institutions for the flow of proper information. The journal *Ordo*, founded in 1948 and edited by Böhm, F.W. Meyer and Hayek, gave the group its name: "Ordo-liberals". "Ordo-liberalism" immediately became, and always remained, West Germany's and later united Germany's reigning economic doctrine (Blum 1969; Streit 1992; Schmiegelow 2009a, b). Hence, it should come as no surprise that German participants in the debate about the subprime crisis tend to emphasize the return to rule-based financial markets. The epistemological genealogies of institutional economics on the one hand and LOT on the other hand are shown in Table 4.1.

Hayek is known as the greatest continental European admirer of common law, considering it as a paradigm of judge-made law responsive to change in an open society. He is therefore an authority frequently cited—though conceivably misread—by LOT (Mahoney 2000; La Porta et al. 2008). And yet he deplored the "one way street" (von Hayek 1973, p. 100) occasionally taken by common law when judges obey *stare decisis* as rigidly as the civil law judges used to apply the codes at the time of the dominance of positivist doctrine. In such cases he saw a necessity for legislation to reopen the legal process. Popper recommended the inverse sequence

Fig. 4.1 Overlap of ordoliberalism and institutional economics. *Source*: Authors' own diagram



at least for countries at the beginning of an open legal process. Referring to Japan's case of rapid transformation from a feudal to a modern economy and society, he urged Russia in 1992 to use the German or the French civil code as a pattern for its legal transformation and subsequently to leave the necessary adjustments to a critical interaction between case law and legislation (Popper 1992).

While Popper and Hayek have come to their considerations on law, economy and society by way of their shared method of critical rationalism, students of comparative law have all along observed a mostly unintended, but sometimes actively sought, process of convergence between common law and civil law. In fact, there is a history of growing importance of legislated law in common law countries and of case law in civil law countries. The common functional requirement is corrective interaction between the two sources of law whenever exclusive reliance on only one of them leads into one of Hayek's "one way streets". How the seemingly complementary opposition between judge-made law and codified law can be resolved in terms of both institutional economics and the constitutional principle of separation of powers is illustrated in Fig. 4.1. The growing importance of statutes in common law countries and of case law in civil law countries is shown by an eclectic tableau of leading examples in Table 4.2.

Hence, from a functional convergence point of view, it matters little whether the US legislator or an American judge is the first to initiate a *rebus sic stantibus* solution to the change of vital circumstances in the subprime crisis. Hopefully, the failed attempt of the "Helping Families Save Their Homes in Bankruptcy" Bill of January 2009 to empower bankruptcy judges in Chap. 13 procedures against mortgage debtors to offer parties the option of mortgage modification will not be the end of the efforts of the US Congress in this direction. Conceivably, banks may

Table 4.2 Convergence between common law and civil law (examples)

Years	Legislation in common law countries	Case law in civil law countries
1677	Statute of Frauds (England): for the protection of inexperienced parties, requirement of written form for sureties, real estate contracts, sales of goods	
1902–2002		In Germany, continuous court rulings on breach of contract by collateral negligence (RG 52, 18)
1911–2002		In Germany, continuous court rulings on "culpa in contrahendo" (RG 78, 239)
1922–2002		In Germany, continuous court rulings on "rebus sic stantibus" (RG 103, 328) following Oertmann (1921)
1933	Glass-Steagall Act (US): Separation of Banking and Securities businesses	
Since 1952	Unified Commercial Code in all 50 US States with default rules similar to civil codes contract laws	
1968–1969	Williams Act (US) on takeovers, (Voluntary) City Code on takeovers (UK)	In Japan, Kumamoto District Court ruling on corporate negligence in Minamata case of toxic emissions (1969)
1977	Unfair Contract Terms Act (UK): nullifying exclusions of liability in any contract	In Japan, Supreme Court ruling on Jouto Tanpo (property pledged as security) in commercial transactions
1979 1982	Sale of Goods Act (UK, 1979) and Supply of Goods and Services Act (UK, 1982) with default rules similar to civil codes' contract law	
1990s	Gramm-Leach-Bliley Act (US, 1999) repealing the Glass-Steagall Act of 1933	In France, recognition of the doctrine of *imprévision* by Court de Cassation in reorientation of French contract law toward standards of good faith (Cass. com 3/11/1992; Cass.com 24/11/1998)
2010	Dodd-Frank Wall Street Reform and Consumer Protection Act (US) reintroducing stricter regulations of banking according to the "Volcker Rule" prohibiting proprietary trading, investment in and sponsorship of hedge funds and private equity funds, and limiting relationships with hedge funds and private equity funds	

Source: Authors' own compilation

become more inclined to yield to such efforts by the healthy profits made in responding to the Federal Reserve's offer to buy MBS in its program of support to the banking sector.[9]

[9] "Wall Street profits from trade with Fed", *Financial Times*, 2 August 2009.

If not, it will be left to American judges to rise to the occasion. It would be surprising if the ALCOA precedent did not encourage at least some of the millions of subprime homeowners to seek judicial relief from the levels of principal and interest of their mortgage contracts for the same reasons Judge Teitelbaum granted such relief to ALCOA from the price formula of its long-term molten metal delivery contract with Essex: citing the doctrines of mistake, impracticality and frustration of purpose. In both cases, "basic assumptions" about future prices were mistaken. The indexed price formula of ALCOA's 1967 molten metal contract with Essex, which was running until 1983, mistakenly assumed normal inflation and could not foresee the rise in electricity prices beginning in 1973 as a consequence of OPEC action to increase oil prices and measures of pollution control. Subprime mortgages mistakenly assumed house price rises beyond historical levels and did not have the cognitive preparation for the severe house price deflation since 2007.

Of course, there are differences between the ALCOA case and the subprime situation. The ALCOA case, as a case of increase in production costs, concerned a micro-economic problem, not obviously comparable with the macro-economic level of the subprime crisis. Earlier common law rulings often declined to recognize increases in production costs as cases of frustration of purpose. Such costs were held to be in the producer's management responsibility (Halson 2001). Arguably one might have expected a corporation of ALCOA's sophistication to hedge against price rises beyond normal trends of inflation. But, then, OPEC's 1973 actions after all did trigger the "first oil crisis", demonstrating how micro-economic or sectorial decisions can affect macro-economic conditions.

From a legal point of view, it cannot matter whether change in vital circumstances occurs in one or the other of the two academic sub-disciplines of economics. Similarly, efforts in German jurisprudence to distinguish between macro-circumstances (*grosse Geschäftsgrundlage*) and micro-circumstances (*kleine Geschäftsgrundlage*) (Esser and Schmidt 1984) have turned out to be of little help, other than to show that changes in macro-circumstances such as economic crises were *a fortiori* calling for judicial relief. Indeed, an economic crisis was what triggered the development of German jurisprudence and case law on change in vital circumstances.

4.5 The Pattern of Change in "Macro"-Circumstances: Germany's Hyperinflation, Paul Oertmann, and RG 103, 328

A ruling of a civil law court has, of course, no authority of precedent in American law. But *RG 132*, *328* may well serve as a transnational pattern of finding a judge-made response to an economic crisis of the gravity of the subprime crisis, just as

civil law versions of the *clausula rebus sic stantibus* did in *Taylor v. Caldwell* in 1863, the first application of the doctrine to an English case of frustration of purpose (*impracticability*) (of a contract for the use of a music hall, by a fire destroying the hall between the making of the agreement and the concert to be performed). "Though the civil law is not of itself authority in an English court", Judge Blackburn (1863) wrote in his judgment, "it affords great assistance in investigating the principles on which the law is grounded" (*Taylor v. Caldwell* 3 B&S 826, at 835).

To be sure, on its way from first instance through appellate court to the RG as the last resort, the case of *RG 132*, *328* was accompanied by the deeply ingrained reluctance of all lawyers (in civil law as well as in common law countries) to interfere with the private autonomy of the contracting parties. All conceivable arguments to find solutions in the terms of the contract were exhausted before the RG set the parties on a rule-based course of renegotiating the terms of the contract, while offering them landmark considerations about how to apply the *rebus sic stantibus* principle to a change of circumstances on the macro-economic level.

The plaintiff sued for the transfer of a 50 % share in a spinning mill sold to him in May 1919 by one of the two associates of a general partnership in liquidation, which had run the mill. The sales contract valued the share at 300,000 Marks. Other details were left to the outcomes of the liquidation, which was to take some time. The plaintiff had declared himself bound by the contract until December 31, 1919. In the fall of 1919, Germany's hyperinflation set in. In January 1920, the plaintiff offered to prolong the validity of his commitment to the contract and declared that he intended to maintain his contractual rights. The defendant responded that he considered the contract obsolete on two counts, mainly the passing of the deadline of contract validity, and failing that, change in circumstances. The Zwickau District Court dismissed the action following the defendant on the first count without discussing the second. The Dresden Court of Appeal upheld the plaintiff's appeal with a rigorous reading of the letter of the contract and the civil code in positivist tradition: the validity deadline was to be understood as being only for the plaintiff to exercise, and contesting the validity of a contract for the mere reason of changed circumstances would call into question the foundations of contract law. The RG found that the Court of Appeal had paid insufficient attention to the supervening event of the hyperinflation, notorious to the Court, since the fall of 1919, which had led to prices of real estate, equipment and inventories rising by many multiples. In the end, the RG referred the defendant's *Revision* (appeal of the last resort) back to the Dresden Court of Appeal for clarification of the facts.

Before doing so, however, it raised the general question whether a considerable shift in the relative real values of the performances of the parties by inflation might under certain conditions justify the plea of changed circumstances. Following Paul Oertmann, it gave an affirmative answer to that question for all cases, in which assumptions about present or future circumstances that have become the evident "*Geschäftsgrundlage*", the basis of the contract, no longer held true. And the RG specifically concluded that the basis of a contract might also unravel as a consequence of a change in the value of money, if the parties could not foresee the change.

But the ruling also gained landmark status thanks to a second reasoning, which stands out by a remarkable fusion of common law and civil law patterns of reasoning. The RG emphasized—in the classical common law spirit, as Alan Farnsworth might have said (Farnsworth 2006, at p. 927)—that it was not in the power of a judge to change the terms of the contract in order to adjust it to changed circumstances by a judgment *in rem*. At the same time, arguing as a civil law court at its best, it stated that the party wishing to terminate the contract had to act in accordance with §242 BGB, i.e. in good faith, by offering the other party the opportunity to propose a modification of the terms of the contract adjusting it to the change in circumstances (*RG 103*, *328*, at 333). Only if the other party rejected that offer, was the party seeking discharge free to terminate the contract. This is exactly the solution codified 80 years later in §313 BGB as part of the reform of the law of obligations in 2002.

Although the RG had to decide on a case of hyperinflation, its reasoning perfectly applies to change in vital circumstances by severe deflation. While inflation between contract date and due date may wipe out a nominal debt, deflation may make it unaffordable for the debtor. Although in 1921, Paul Oertmann, to whose monograph the RG referred, could not have foreseen the deflation of the Great Depression, he did address the question of opposite price effects of rising and falling business cycles. He stressed that, in other than speculative deals, "basic assumptions" of the two parties can be disappointed in both circumstances (Oertmann 1921, at 136 and 178).

The case of the subprime crisis is one of frustrated assumptions about rising house prices, which would have made debt service affordable for the debtor through refinancing. If a revaluation of debt was the RG's solution in a case of hyperinflation, its logic would require a devaluation of the debt in a case of deflation. This is precisely what the Obama Administration had hoped the US Congress would empower bankruptcy judges to do in the "Helping Families Save Their Homes in Bankruptcy" Bill of January 2009: reduce principal and interest of subprime mortgages in view of the severe deflation of house prices since 2007.

4.6 The "Basic Assumption" of House Price Inflation as a Vital Circumstance for Subprime Mortgages

As traced by Salmon (2009), an application of a standard mathematical formula, the Gaussian copula function, to mortgage default correlations was published in 2000 by Li, a mathematician ("quant") at JP Morgan Chase (Li 2000). It was severely flawed by an implicit assumption of a continued rise of real estate prices far beyond the historical trends (Shiller 2005, Fig. 23). The assumption was derived from less than a decade of available price statistics of CDS, conveniently the period of the last real estate boom. But it was transformed into a mathematical constant reducing the theoretical probability of mortgage defaults. American banks used this magic

formula enthusiastically to justify mortgage lending to subprime homebuyers in the US. Subprime mortgages were "packaged" in small slices with prime mortgages in MBS. These MBS in turn were repackaged in collateralized debt obligations (CDO). This architecture of "structured credit" was exponentially enlarged by repackaging CDO's into "CDO's squared", and CDO's squared into "CDO's cubed". These securities were rated AAA by the three American rating agencies, insured at low cost by CDS, and sold globally to banks trusting financial innovation from Wall Street. The result was a financial bubble in the US with pervasive global effects. CDS reached a volume of US$60,000bn.

In hindsight, it is easy to agree with the characterization of this kind of mathematics as "fiendish Frankenstein Monsters" in Paul Samuelson's narrative of the subprime crisis. When the subprime mortgage contracts were concluded, however, the collective conviction on Wall Street, on Main Street, on the boards of German *Landesbanken* and in the offices of their special purpose vehicles in Ireland, was that financial innovation had opened a path beyond historical trends.

4.7 House Price Deflation Since 2007 as a Supervening Event

Along with this collective conviction, "basic assumptions" of both borrowers and lenders of subprime mortgages began to be frustrated in 2007, when the first American subprime lenders defaulted, as subprime borrowers could not afford the rise from the initial "teasing" rate of about 2 % to the eventual contractual rate of about 8 % of the mortgage. The first of an ongoing series of waves of foreclosures brought real estate prices down. MBS became "toxic assets". The global financial bubble burst a year later, when the US Treasury and the Federal Reserve allowed Lehman Brothers to default, as a—now belated—warning to the banking sector against reckless risk taking.

As already mentioned above, by mid 2009, some 15 million homes in the US were in negative equity, as the value of the home covered only reduced percentages of the principal of the mortgage. While the overall US consumer prices could still be considered as being just in a state of disinflation, house prices suffered massive deflation. Homeowners were hit by severe declines of the value of their homes, shattering the assumed prospect of refinancing on the basis of rising values in the foreseeable future.

This onset of the worst economic crisis since the Great Depression was neither foreseen by the lenders nor foreseeable by the borrowers. In terms of the doctrine of mistake referred to by Judge Teitelbaum in the ALCOA case, it was not only a mistake of two individual enterprises concluding one contract, but a collective mistake of an entire industry and an entire community of economists and mathematicians supporting it with concepts of innovation assumed to be rock solid. For subprime mortgage borrowers there was no way of checking that assumed solidity.

To expect them to hedge against the risk of declining instead of rising house prices would mean to demand of them a cognitive sophistication that the financial industry itself did not muster. Moreover, households considered subprime by the financial industry, as a rule have no access to hedging.

The collective nature of the mistake was explained in a letter of the British Academy dated July 22, 2009 to the Queen. During a visit to the London School of Economics in November 2008, the Queen had asked why nobody had noticed that the credit crunch was on its way. To prepare the response, the British Academy held a forum of more than 30 eminent economists in June 2009. Their conclusion conveyed to the Queen was that "the failure to foresee the timing, extent and severity of the crisis and to head it off, while it had many causes, was principally a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks of the system as a whole".[10]

4.8 The American Recording System as an Impediment to Rapid Crisis Resolution

The immediate across-the-board application of the *rebus sic stantibus* principle on a notional basis would also open a temporary "bypass" around a particular institutional barrier impeding the rapid resolution of the subprime crisis in the US: the mortgage records. Recent studies linking comparative law and econometric measurement have found that the American system of recording real estate transactions is more costly and time-consuming than the public registry systems existing in a large number of other countries, as the recording office must accept all signed documents whatever their legality and their collision with preexisting rights (Arrunada and Garoupa 2005; Arrunada 2011). Title examiners are needed to examine all deeds dealing with the concerned parcel of land in the past and to certify the legality of the mortgage document in question. This is lucrative business for title examiners, but the risk of legal uncertainty remains with their clients. Hernando de Soto, the Peruvian scholar of the deficiencies of property law in developing countries, has compared the US recording system to dysfunctional conditions in Latin America (de Soto 2009). TARP Inspector Neil Barofsky understandably called for supervised screening of each mortgage slice packaged in each asset-backed security to prevent conflicts of interest or fraud. Given the structural impediment of the American recording system, this promises to slow the solution, and magnify the cost, of the crisis to an incalculable extent. Hence, write-downs of toxic assets re-priced on the basis of a notional application of *rebus sic stantibus* would be in the best interest of the world's damaged economies.

[10] Credit crunch explained to the Queen, *Financial Times*, 3 August 2009, available at http://www.ft.com/cms/s/0/7e44cbce-79fd-11de-b86f-00144feabdc0.html.

In the future, US States might consider replacing the recording system by the public registration of rights system as in Australia, Denmark, Germany, Japan, Spain (Arrunada 2011) and, most recently, China (Rehm and Julius 2009). Under such a system, registration of a new right requires first a purge of all prior contradictory rights. In civil law countries, the notary authenticating the property sale or mortgage is bound by law to examine the legality of the contract and the absence of contradictory rights before conveying it to the registry. Only such a system makes securitization of mortgages and trade in such securities easy and safe, as anybody can check the identity and contents of the mortgages involved in the public registry at any time. Its adoption in the US would remove a major institutional bottleneck for financial innovation. But the solution to the subprime crisis cannot wait for such a long-term institutional change. Hence, the immediate notional application of *rebus sic stantibus* to re-pricing MBS should be understood as a functional second best solution for this particular crisis rather than a precedent for the future. The legal and institutional issues will have to be solved by the legal process on legislative and judicial levels.

4.9 The Urgency of Cognitive, Legislative and Judicial Progress Towards Solving the "Balance Sheet Recession"

While there is global agreement on the origin of the subprime crisis and its rapid degeneration into a global economic crisis, the worst since the Great Depression, there are multiple disagreements about the proper solutions. The divergence between unanimity in problem analysis and dissension on policy response is alarming. It suggests an inability or unwillingness to learn the lessons of economic history. Reluctance to learn other than the well rehearsed monetary lesson (Fisher 1933; Friedman and Schwartz 1963; Bernanke 2002) of the Great Depression may be forgivable, since the above-mentioned tensions between the legislative and the judicial branches at the time of the F.D. Roosevelt Administration have hardly been in the focus of economic policy discourse since then. But policies disregarding an example as recent and as telling as Japan's "lost decade", a term that has become conventional among economists referring to the failure of both macroeconomic policies and balance sheet adjustment in addressing Japan's debt deflation from 1991 to 2001 (Yoshikawa 2001; Saxonhouse and Stern 2004; Summers 2011), are precarious policies indeed.

After the bursting of the Japanese bubble in the early 1990s, Japan spent a decade in fruitless attempts at different fiscal and monetary crisis solutions without a prior cleanup of the financial sector. Only in March 2002, when Prime Minister Junichiro Koizumi had succeeded in prodding all agencies involved to cooperate, was a pragmatic strategy combining short-term anti-cyclical fiscal and monetary policies with structural reforms of the financial sector devised. Only in October

2002, when Koizumi appointed the determined reformer Heizo Takenaka as Head of Japan's Financial Services Agency, were the balance sheet problems of the financial sector seriously addressed. Takenaka enforced a fair value re-pricing of bank assets and rigorous write-downs of non-performing loans combined with recapitalization and restructuring of the banking sector. Only then did Japan's banks recover the ability of financial intermediation in the economy. They began responding functionally to the Bank of Japan's then path-breaking policy of quantitative easing by passing on the liquidity to recovering credit demand in the real economy (Schmiegelow 2002, 2003). In the third quarter of 2003, the success of these policies was demonstrated: the Japanese economy bounced backed with an annualized growth rate of 6 %.

While the effects of the bursting of the Japanese bubble, though severe and prolonged for Japan, remained contained within the Japanese economy, the US subprime crisis caused a crisis of confidence in the global banking sector and hence a global economic meltdown. Uncertainty about the exposure of individual banks to toxic assets put credit markets in a state of freeze. European banks had massively participated in the frenzy of securitization of US mortgages (Dam 2010). With the notable exception of Deutsche Bank, which like Goldman and Sachs reportedly had doubts about the assumed rise of real estate prices and hedged its bets, scores of European banks including Germany's leading real estate lender Hypo Real Estate and several public *Landesbanken* "followed the herd" in trusting financial innovation. When they noticed the trust was unwarranted, they realized that their exposure was out of proportion with their capital. Unable to put a value on toxic assets and, just like their Japanese colleagues in the 1990s, not daring to proceed to write-downs for fear of being nationalized, they stopped lending and thus no longer assumed their function of financing the real economy. Hence even loans unrelated to toxic assets became non-performing and the latent need for further write-downs grew, a vicious circle. In a first attempt at quantifying necessary global write-downs in April 2009, the IMF (2009b) estimated $4.1 trillion, with $2.7 trillion of bad loans and securities originating in the US and $1.12 trillion in Europe. Japan, whose banks, sobered by their own bubble experience, had hardly touched MBS, faced "only" $149bn.

Early hopes that the still thriving industrial sectors of exporting countries like China, Germany and Japan might remain unaffected by the collapse of the US financial sector quickly evaporated. On the contrary, they became the countries worst affected with declines in exports in the first months of 2009 in the ranges of 21.1 % (Germany), 25.7 % (China) and 46 % (Japan). On July 8, 2009, the IMF predicted a deeper recession in Europe and Japan than in the US, with declines of GDP in 2009 of 2.6 % in the US, 6.2 % in Germany and 6.0 % in Japan (IMF 2009c). For Keynesians, the reason was obvious: the hitherto most important sources of global demand, i.e. the Anglo-Saxon countries combining low savings and high consumption propensities with structural fiscal and external trade deficits, had suddenly disappeared from the international trade equation.

These figures underscore the urgency of adopting the right strategies to resolve the crisis faster than in Japan's lost decade, but with the strategic pragmatism (see

Schmiegelow and Schmiegelow 1989) that helped Japan to recover within 12 months in 2002/2003. Unfortunately, so far, dogmatic dissension and, hence, cognitive confusion prevail. Sometimes, the disagreement appears to be between nations, such as between France and Germany or France and the UK, or between groups of nations, such as the transatlantic divisions or those between the "Anglosphere" and the "rest of the world", or the G7 and the G20. In fact, the most acrimonious debates are domestic ones in the countries worst affected by the global melt-down, between monetarist and Keynesian economists everywhere, Republicans and Democrats, Wall Street and "Main Street" in the US, defenders of common law or of civil law in transforming countries, advocates of laissez-faire and proponents of social protection everywhere again.

The US had the initial advantage of a new administration with huge popular support, while Germany's coalition government was compelled to focus on elections in September 2009. To the global media, Japan, France and the UK appeared much more eager for action than Germany. But as attested by the IMF (2009a) in February 2009, with one of the most generous social security systems of the world functioning as an automatic stabilizer, Germany was devoting 3.4 % of GDP to fiscal stimulus, the third largest proportion of major economies after the US (4.8 %) and China (4.4 %), but before Japan (2.2 %), the UK (1.5 %) and France (1.3 %). In May 2009, Japan surged to the top with a supplementary budget adding 3 %, bringing the country's total to 5.2 %. And yet, just as in Japan's lost decade, the debate about whether Keynesian stimuli provided so far were sufficient or not, goes back and forth. "Exit strategies" are intensely discussed, while most participants in these discussions, foremost among them Ben Bernanke,[11] are convinced that it is far too early to apply them.

However, even though more fiscal or monetary stimulus may be needed to preempt "double-dip" or "triple dip" recessions in various countries with intermittent short-lived recoveries, it will not address the roots of the subprime crisis, which rightly has come to be called a "balance sheet recession" because of its origins in the balance sheets of the financial and household sectors, just like Japan's debt deflation after the bursting of the Japanese bubble in 1991. The term "balance sheet recession", now applied to the subprime crisis by Michael Spence, the former Dean of Stanford Business School whose work on information asymmetries was awarded the 2001 Nobel Price, was first coined for the Japanese recession of the 1990s by the Head of the Nomura Research Institute, Richard Koo, in 2003 (Koo 2003). Michael Spence has emphasized the tremendous depth and destructive power of the balance-sheet meltdown characterizing the subprime crisis. "In the future", he writes, "central banks and regulators will not be able to afford a narrow focus on (goods and services) inflation, growth, and employment (the real economy) while letting the balance-sheet side fend for itself. Somewhere in the system, accountability for stability and sustainability in terms of asset valuation, leverage, and balance sheets will need to be assigned and taken seriously" (Spence 2009).

[11] "Bernanke outlines exit strategy", *Financial Times*, 22 July 2009.

Japan's lost decade should serve as a warning of what happens as long as balance sheets are not taken seriously.

Unfortunately, then US Treasury Secretary Timothy Geithner's efforts to stabilize the American banking system by public–private partnerships have initially been perceived, on both sides of the political spectrum, as relying to an uncomfortable degree on the very same market participants whose collective cognitive failures are at the origin of the crisis.[12] TARP Inspector Barofsky warned that not enough has been done to guard against fraud in a program offering public money to private investors who buy toxic assets. Geithner's programs required banks holding such assets to sell them, which for fear of having to write down the realized losses after such sales, they have been reluctant to do, all the more so as Neil Barofsky called for supervised screening of each security. As neither prospective sellers nor prospective buyers had a clear idea about the value of the toxic assets, the process promised to be protracted. The "market" cannot clear as anticipated, as its "sell side" (banks and brokers) and its "buy side" (pension funds, hedge funds, insurers) are competing for influence on regulators with different concepts of crisis resolution and prevention.[13]

Of course, law suits between mortgage lenders and borrowers as well as sellers, buyers and insurers of mortgage-backed securities have begun in the US[14] and may take many years at considerable legal cost, the longer they last, the higher the cost. As explained in Chap. 5, civil procedure is structurally more costly and time consuming in common law countries than in most European civil law countries. Rather than the judge, the lawyers of both sides determine the pace of procedure (Schmiegelow 2013). They tend to engage in pretrial discovery until a settlement is reached. The number of court rulings, the source of judge-made law, is regrettably declining in the US (Gallanter and Frozena 2011). Even though parties that would benefit from contract modification may have already made their case in the legal terms of change in vital circumstances, there is no movement in jurisprudence, as long as settlements preclude court rulings.

There have been several such settlements in the 5 years following the outbreak of the subprime crisis. One is Bank of America's $8.5bn deal with MBA investors reached in June 2011,[15] only to be questioned by New York Attorney General Schneiderman in July 2011[16] and still waiting for court approval in 2013.[17] Another is the settlement reached in February 2012 by a group of Federal and State agencies and 11 banks obliging the banks to provide relief to mortgage borrowers and aid to states for foreclosure prevention amounting to a total $26bn, at least $17bn of which

[12] "Wall Street ties cast cloud over Geithner", *International Herald Tribune*, April 18, 2009, 1, 16.

[13] "On the March", *Financial Times*, June 9, 2009, 9.

[14] "A battle to place blame for a flawed, costly bet", *International Herald Tribune*, January 30, 2009, 9.

[15] *New York Times*, June 29, 2011.

[16] *New York Times*, July 13, 2011.

[17] Reuters, January 7, 2013.

for reductions of mortgage principal (US Department of Justice 2012), only to be found wanting by the New York Times as the amounts seem "paltry" considering four million mortgage borrowers having lost their home in foreclosure, 3.3 million more in or facing foreclosure procedures, and further 11 million homeowners in negative equity by an estimated $700bn.[18] The biggest settlement with a single bank until the end of 2013 was the $13bn settlement reached by the US Department of Justice and the Attorneys of several States with JPMorgan Chase & Co on November 19, 2013, the bulk of which goes to wronged investors. Still, $4bn are earmarked for mortgage modification, half of that for principal reduction and half for lowering interest rates (US Department of Justice 2013). Given that the settlement covered around $1tn mortgages sold to investors by JP Morgan, Washington Mutual and Bear Stearns from 2004 to 2007, the deal was characterized as a good one for JPMorgan by the New York Times Deal Book.[19] Hence, we cannot guess how many more years it will take until a seminal court ruling takes Judge Teitelbaum's reasoning from the micro-level of the ALCOA case to the macro-level of *RG 103*, *328*. The US economy, as well as the world economy, continues to appear dependent on the outcomes of lobbying campaigns and legal battles in the US.

While some green shoots have been sprouting in the real economy since 2009, US banks and European banks similarly burdened by legacies of the subprime crisis continue to be reluctant to lend to other than practically risk-free borrowers. Instead of being "liquidity providers", too many have become "liquidity users".[20] Just like Japanese banks in the 1990s, they are reluctant to assume their essential economic function of financial intermediation on a level that a sustained recovery would require.[21] The German legislation, adopted in May 2009, to allow each German bank to isolate toxic assets in a separate "bad bank" is a strategy of buying time until market dysfunction ends in the US, which will not happen until the legal issues discussed in this chapter are addressed in the US.

The "stress tests" repeatedly conducted by US regulators on the top US banks since 2009 were designed to offer a perspective of the sheer survival of those banks rather than to encourage the building of sound new banks ready to channel credit to a struggling economy. The projection of combined losses of $599bn over 2009 and 2010 announced on May 7, 2009[22] did not lift the cognitive fog covering MBS. "Just in time" for the stress tests, on April 2, 2009, the Financial Accounting Standards Board (FASB) responded to pressure from the US Congress to change the accounting rules for banks. Rather than applying the mark-to-market rule which forces them to report the losses on asset backed securities, they were allowed to use

[18] *New York Times* Editorial, March 17, 2012.

[19] New York Times Deal Book, November 20, 2013.

[20] *Financial Times*, supra note 31.

[21] Tett (2009).

[22] "Stress tests show $75bn buffer needed", *Financial Times*, May 7, 2009.

"internal models" in view of "conditions indicating that markets were dysfunctional".[23]

This was strikingly reminiscent of Japan's decade of fruitless attempts at different fiscal and monetary crisis solutions without a prior cleanup of the financial sector. During that decade, Japanese banks were similarly protected against revealing the extent of their capital shortfall. Similarly, they became liquidity users rather than liquidity providers. And similarly they failed to recover the confidence essential for the functioning of financial markets. When the Koizumi government finally imposed fair value re-pricing of bank assets and corresponding write-downs of bad loans in 2002 as mentioned above, it did so in response to intense prodding by the US government and American banks. The immediate success of that strategic policy reversal perfectly vindicated the validity of the American arguments at that time. These are lessons to be remembered in 2013, half a decade after the onset of the subprime crisis.

They suggest that further cognitive efforts must be undertaken, before new policies can be designed to put the global economy on the path of sustained recovery. The most urgent step must be to consider the following four propositions:

- no matter how low or far into negative territory monetary policy pushes interests rates, no matter how large a share of GDP fiscal stimulus programs reach, there will be no sustained recovery without a cleanup of the balance sheets, and commensurate rebuilding of adequate risk capital, of the banks burdened by MBS and potentially threatened by CDS;
- there will be no cleanup of balance sheets without re-pricing MBS;
- there will be no re-pricing of MBS without a functional legal solution to the problem of change in vital circumstances of all contracts involved in the subprime mortgage market, at least on a notional basis;
- there will be no functional legal solution to the problem of "change in vital circumstances" in the subprime market other than contract modification.

4.10 A Notional Application of *rebus sic stantibus* Pending Legislative, Executive or Judicial Solutions in the US

In conclusion we submit that the only immediately productive result of these cognitive steps, pending legislative, executive or judicial solutions, would be the notional application of *rebus sic stantibus* on a voluntary basis by all parties concerned.

The initial teasing rate of about 2 % for subprime mortgages would continue to apply, since the vital expectation of rising house prices that would make rising mortgage rates affordable for subprime owners failed to materialize. Beyond that

[23] *Wall Street Journal*, supra note 19.

2 % level, foreclosures would be considered as inadmissible in terms of good faith. The principal would be reduced in line with levels of pre-bubble house values. To preempt arguments of complete contract discharge of mortgage debtors, banks would open negotiations on mortgage modification across-the-board with their subprime clients by an offer of the terms just mentioned. As discussed above, the draft of the "Helping Families Save Their Homes in Bankruptcy Act" introduced by the Obama Administration in January 2009 was the functional equivalent of a first attempt to seek a *rebus sic stantibus* solution by a change in the bankruptcy law giving judges the power to present the parties with the functional option of reducing the principal and interest of subprime mortgages. Opposing that provision through the lobbying campaign already referred to, the banks failed to understand that they were acting against their own best interest, since historical evidence shows that lenders loose 40–50 % of their investment in a foreclosure situation, and since every new wave of foreclosures contributes to the vicious cycle between foreclosures and house price declines (Levitin 2009). We submit that sooner or later, the losses from a continuing downward pressure on house prices will make the attraction of ending the cycle of foreclosure, house price declines and further mortgage delinquencies by *rebus sic stantibus* solutions apparent to the banks.

"Quants" may help by "decontaminating" the Gaussian copula function. They might remove the flawed constant of stable CDS prices implying rising real estate prices, and base mortgage default correlations on reliable historical trends as documented in the Case-Shiller indexes (Shiller 2007). The presentation of the "Deutsche Bank Prize in Financial Economics" to Robert Shiller by Josef Ackermann on September 30, 2009[24] may be understood as a pioneering signal to the banking sector in this sense.

Without the pressure of foreclosures, housing markets in the most affected areas of the US would bottom-out faster and in a more sustainable measure. Re-pricing of MBS and write-downs in bank balances could begin immediately on the notional basis of a return to the initial 2 % interest and a reduction of the principal in line with levels of pre-bubble house values for all slices of subprime mortgages. As could the adjustment of risk capital of banks to adequate levels on the basis of clean balance sheets, sooner and cheaper for the taxpayer, and the more profitable for the financial sector.

The time lag between immediate notional re-pricing of MBS in all relevant balance sheets and the closure of negotiations on contract modification, which will take more time, should be a manageable problem. The two tasks should be considered as parts of a two-track process linked by a feedback loop. Contract modification and balance sheet adjustment should be initiated simultaneously, the latter anticipating the former and the former correcting the latter. As part of substantive law, contract modification would, of course, be the independent

[24] "Ein Preisträger, der eine Zeitenwende markiert", *Handelsblatt*, October 1, 2009, 21; on the motives of the award see *Reuters News* 11 February 2009, available at http://www.reuters.com/article/pressRelease/idUS90172+11-Feb-2009+PRN20090211.

variable. It would control balance sheet adjustment, the dependent variable, for the sake of accounting veracity.

Since mitigation of pro-cyclicality was also a goal of the 2009 G20 Pittsburg summit communiqué, the choice between several conceivable outcomes of negotiations on contract modification might anticipate that reform goal. Write-downs may therefore justifiably make the best-case assumption of the negotiation outcome, although even the worst cases would still be much more favorable for the financial sector than letting foreclosure waves roll on unchecked or facing the risk of ever more onerous settlements with the SEC, or even eventual court rulings offering borrowers complete discharge from mortgage contracts. Of course, what has been written down should also be written up in case of a sustained recovery of house prices, with due attention to avoidance of pro-cyclical effects, in this case, by making worst-case assumptions on expected outcomes. Hence negotiated agreements for downward modification of contracts should contain clauses permitting further modification of terms in case of a materially favorable change of circumstances. In this way Hayekian spontaneous order would extend from modified mortgage contracts "on the ground" through re-priced MBS and CDO to the adjusted balance sheets of both the "sell-side" and "buy-side" of financial markets.

Such a notional anticipation of contract modification as a requirement of good faith in cases of macro-change of circumstances should be sought independently from the debate on regulation and deregulation. Of course, the reform of regulatory regimes of accounting, capital requirements and compensation practices in the financial sector projected by the 2009 G 20 Pittsburg summit[25] merits support, although it may fall short of the most ambitious expectations. But nothing will be won by putting the proposed *rebus sic stantibus* solution off until these reforms are implemented or consecutively improved. On the contrary, balance sheet deterioration will go on unchecked in the meantime with consequences for the economy as deplorable as in the Japanese case before determined action was taken in 2002.

The October 2009 Global Financial Stability Report of the IMF added urgency to this concern. While acknowledging improvements in global financial stability with global losses reduced by $600bn to $3.4 trillion—largely due to rising securities values in mid 2009—it warned of further credit deterioration, as over half of potential write-down needs through end-2010, estimated at $1.5 trillion, had to be recognized. It emphasized that banks needed to crystallize losses through realistic assessment of asset values and that capital levels may need to rise further to rebuild lending capacity for finance recovery. The IMF urged banks to use the chance of extremely low interest rates, wide spreads and, hence, high profitability, prevailing since 2009 for this purpose. It warned that such favorable conditions may not last, as public credit demand resulting from the massive programs of fiscal stimulus in all major economies might eventually exert upward pressure on interest rates (IMF 2009d). Our argument in this chapter is that losses and hence capital needs will crystallize at lower levels with *rebus sic stantibus* contract modification

[25] For the summit communiqué see Full G20 Communiqué, *Financial Times*, 25 September 2009.

than with a posture, contrary to critical rationalism, of maintaining untenable legal positions while letting the chain of crisis causation to continue running its course.

Legal philosophy and the economic analysis of law offer a more fundamental reason for immediate autonomous action on the level of private law independently from regulatory reform. Hayek distinguished between general rules of substantive law orienting the behavior of market participants in the long run and organizational rules designed to achieve particular outcomes within a shorter timeframe (von Hayek 1973). The *rebus sic stantibus* rule in civil law and American common law is of the former kind, the new regulations discussed on the G 20 level and enacted in the US by the Dodd-Frank Act of 2010 are of the latter category. George Soros (2008) saw a reflexive relation between regulators and financial markets. Specialized regulatory systems will always be behind the curve of financial innovation, if not of regulatory arbitrage in financial markets.

As explained in Chap. 3, civil law and common law have a longer life than economic cycles. By setting timeless standards of good faith and by offering institutions designed to reduce information asymmetries at all times, they can stabilize markets beyond the shorter cycles of both financial innovation and regulation. They can flatten the "tsunamis" of boom and bust lamented today by US lawmakers and bankers alike, even when today's new regulations will again be found "behind the curve" of innovation in the future.

Finally, our case qualifies LOT's assumptions about the adaptive superiority of common law over civil law and refutes broad-brush characterization of common law as judge-made law and civil law as politically motivated legislation. We have shown that the *rebus sic stantibus* rule is universally recognized as a principle of adjustment of contracts to supervening events. Traceable to Roman law sources it was revived by civil law scholarship and found entry into some civil codes before influencing first English, then German and finally American court rulings. The German and American rulings pioneered contract modification as an adjustment to economic crises resulting from unforeseeable massive inflation as supervening event. Their adaptive logic applies equally to the deflation of American house prices that invalidated an entire cycle of financial innovation. The greatest challenge to LOT is that the American response to the crisis has been massive on legislative and regulatory levels, but, so far, absent in the field of judge-made law.

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Chapter 5
A Counterintuitive Efficiency Divide Between Common Law and Civil Law: Rules and Structures of Civil Procedure in Eight Developed or Newly Industrialized Countries

Henrik Schmiegelow

5.1 Introduction

The original interest of legal origins theory (LOT) in the 1990s was to explain why capital flowed so much more massively to New York and London than to Paris and Frankfurt. In what impressed many thoughtful economists as an interesting departure from the efficient market hypothesis, it focused on behavioral patterns and legal rules encouraging the provision of capital to financial markets. LOT's most influential thesis was and still is that common law as applied in New York and London encourages uninformed capital owners to trust professional insiders acting as agents in the best interest of their principals (La Porta et al. 1997, 1998). While not distinguishing explicitly between substantive law and procedural law, their conclusion that common law is superior economically to civil law was generally understood as an argument about substantive rules of corporate law, securities law and regulation of financial markets. Hence the ensuing debate focused on these same areas. Just like the contract laws of the eight paradigm countries discussed in Boucekkine et al. (2010), civil procedure remained a missing variable.

It was left to Simeon Djankov and three leading authors of LOT to enter the field of "Courts" in 2002 in cooperation with Lex Mundi, a worldwide association of law firms (Djankov et al. 2002). They argued that common law civil procedure was closer to the ideal case of two parties informally entrusting their dispute to their neighbor's judgment as conceptualized by Shapiro (1981) than civil procedure in civil law countries, which they assumed to be inefficiently formal. They constructed an index of 44 indicators of procedural formalism of dispute resolution, compared it with data from the World Bank Business Environment Survey (2000) and arrived at the conclusion:

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> Formalism is systematically greater in civil law countries than in common law countries (and) associated with higher expected duration of judicial proceedings, more corruption, less consistency, less honesty, less fairness in judicial decisions and inferior access to justice (Djankov et al. 2002, p.1)

While they were able to reach the impressive level of econometric robustness of most static cross country analyses by collecting responses from Lex Mundi member law firms in 109 countries, they relied on the extremely narrow base of only two types of cases: eviction of tenants for non-payment of rent and collection of bounced checks. They argued that this narrow focus allowed them to highlight procedural differences in their broad sample of countries. Moreover, the two paradigm cases were further narrowed down to a hypothetical situation where the plaintiff is 100 % right and the defendant 100 % wrong, and where the defendant maintains a poorly justified opposition, appears at hearings to deprive the court of the option to shorten the procedure by a default judgment, is unwilling to settle, insisting on the issuance of a formal judgment and prefers enduring the enforcement of the judgment rather than complying with it voluntarily.

In 2007, LOT raised the level of economic relevance of their venture into the procedural field significantly in a study of the much more broadly defined case type of enforcement of contractual debt worth 50 % of GDP pc in 129 countries (Djankov et al. 2007). At the same time, the larger country sample even more clearly revealed the methodological pitfalls of large country samples with overwhelming majorities of former colonies, more than 50 % of which coded as of French legal origin ("LO"; each time I mention "legal origin" in the—often questionable—sense of LOT's coding of countries in this chapter, I will use this abbreviation). Unwittingly, LOT measured the transplant effect of colonial imposition of imperial laws to unreceptive countries rather than the relative quality of common law and civil law. I will briefly survey the most evident methodological strengths and weaknesses of this approach in Sect. 5.2.

In the interest of a sharper focus on the comparative quality of procedural rules and judicial structures of common law and civil law countries not affected by the transplant effect, I propose an alternative strategy in Sect. 5.3, using a broader set of indicators of procedural quality without case type limitation and a much narrower sample of countries whose legal and economic histories can be considered as paradigms of development under common law or civil law. Extending the set of indicators of civil procedure beyond formalism makes it possible to identify crucial cost and time factors in basic procedural rules and structures of judicial supply affecting access to justice and economic development. The indicators I will use are those of the questionnaire on rules and structures of civil procedure prepared for the conference on "Legal Origins and Access to Justice in Developing and Transforming Countries" at the University of Louvain in Louvain-la-Neuve on February 16–17, 2012 (Schmiegelow and Schmiegelow 2012), hereafter cited as "Louvain Questionnaire".

I submit that, before engaging in comparative analysis of civil procedure in different legal systems, one should clarify one's understanding of the functions of substantive law such as contracts, torts or trust and estates as taught in American

law schools on the one hand, and procedural law and judicial institutions on the other. This will also help to organize the debate on access to justice in its two senses of access to justice in the material sense and access to the judiciary or fora of alternative dispute resolution (ADR). In this chapter, I will understand the function of substantive law as the expression of the aspirations of a society to let justice in the large political, economic, social and cultural senses prevail in the relations between citizens as well as between citizens and their government. I will assume the function of procedural law and judicial or ADR institutions to be as follows:

- to transform substantive law "on the books" into applied, practiced law, evolving, in the best cases, by a continuous stream of judicial rulings published and commented on in common law "law books" or civil law "commentaries" as well as in the media;
- to provide access to the judiciary or ADR

  at low cost
  without undue delay (in view of the maxim "justice delayed is justice denied").

The factor "without undue delay" is also present in LOT's focus on duration in civil procedure. The cost factor, however, is conspicuously absent from Djankov et al. (2002, 2007), perhaps not surprisingly, given its reliance on global networks of lawyers as sources, and given the difficulty, for lawyers themselves, to predict levels of lawyers' fees negotiated with clients or calculated per hour of time spent for them. Also absent is the function of procedural law and judicial institutions to transform substantive law into applied law by judicial rulings, which is surely surprising given that LOT bases its very thesis of the superiority of common law on its origin as judge made-law. Elsewhere, in writings on law and finance (Beck et al. 2003; Rajan and Zingales 2003), it does emphasize the functional advantage of judge-made law as an "adaptability channel" (Beck et al. 2003) of the legal process. In contrast, it considers legislated law, such as civil codes, as passing through a "political channel" (Rajan and Zingales 2003) with a "regulatory bias" prone to dysfunctional rent seeking. It is all the more intriguing that LOT remains silent on this distinction in its writings by Djankov et al. (2002, 2007) on procedural law, which is the very *sedes materiae* of judicial decision-making. Therefore, it appears appropriate to have a second look at this subject in the context of civil procedure.

The most important procedural rules are those determining the balance of the roles of judges and lawyers as providers of the necessary knowledge of the substantive law governing the dispute or as managers of the pace of the procedure. Professional judges supplying their legal knowledge as a public good may offer more affordable and speedier justice than judges in the role of a passive referee waiting to be convinced by the arguments on points of fact and points of law offered by the lawyers of both sides. Infrastructures such as training, status and pay of judges and lawyers, as well as the density of courts, judges and lawyers per 100,000 inhabitants are important indicators of how far judicial supply responds to, or encourages, demand for law. Comparative litigation densities may be understood

as a result of the interaction between institutional supply-push and demand-pull. The comparative frequency of published judicial decisions can serve as evidence of how far judge-made law contributes to the adaptive quality of the legal process in common law and civil law countries.

The XVIIIth World Congress of Comparative Law in Washington DC in 2010 issued a report on rules of allocation of court costs and lawyers fees covering common law, civil law and mixed jurisdictions around the world. Cost and fee allocation is a decisive factor of the predictability, or lack thereof, of the costs of going to court and hence indicators of access to justice (Reimann 2012). The European Commission for the Efficiency of Justice (CEPEJ) set up by the Council of Europe in 2002 has done pioneering work collecting data on judicial infrastructures, litigation rates and duration of civil proceedings in the 47 member states of the Council of Europe including the UK (CEPEJ 2008). In the US, the Court Statistics Project (CSP) jointly launched by the Conference of State Court Administrators (COSCA), the Bureau of Justice Statistics (BJS) and the National Center of State Courts (NCSC) in 2011, has chosen a similar approach for the analysis of the functioning of the American state courts system since 2010 (LaFountain et al. 2012). The methods of the CEPEJ reports and of the CSP are transcultural and there is no reason not to use their data or to attempt obtaining similar data through academic research in non-member countries in other parts of the world.

Limiting the sample of countries to paradigms of economic development offers the prospect of correlating their economic and legal history in dynamic panel analysis over long time series. I propose to select the same eight developed or newly industrialized countries already compared by Boucekkine et al. (2010, Chap. 3) in their analysis of the economic impact of substantive contract rules. That sample includes the mother countries of English, French and German LO, three of the largest financial centers (UK, US and Switzerland), the US as the major case of a nation of settlers and traders bringing their English common law with them (Acemoglu et al. 2005), two newly industrialized countries (South Korea and Taiwan), and three divided countries with separated legal and economic trajectories serving as quasi natural experiments of law and economics (China, Germany, Korea). In the case of India, which may be used for the purpose of robustness checks of dynamic panel analysis as in Boucekkine et al., a similar experiment suggests itself in comparison with Burma, which as a part of British India shared the common colonial heritage of Anglo-Indian law before a succession of military coups after independence dislodged it from the common law legal origin (Chap. 3). In this way, the sample illustrates the transplant effect and, at least for three countries of the sample, avoids the objection of reverse causation of wealth leading to institutional development rather than institutions to economic development (Docquier 2012, Chap. 2).

The evidence of cost and time factors of civil procedure and judicial structures in that sample, most of them established at approximately the same period as substantive contract and property laws, suggests conclusions very different from LOT's. There are some surprising similarities in formal procedural and judicial patterns of the common law and civil law countries of the sample. The most striking difference,

however, emerges in the balance of the roles of judges and lawyers as providers of legal knowledge or as managers of the pace of the procedure. This difference most clearly follows the common law/civil law divide, on which LOT continues to insist, but with scores of efficiency, adaptive functionality and judicial productivity squarely contradicting LOT's assumptions on the comparative quality of common law and civil law. If the balance of the roles of judges and lawyers as providers of the necessary knowledge of the substantive law governing a dispute or as managers of the pace of the procedure is taken into account, three results emerge: (1) Civil procedure in common law countries takes more time and is more costly than in civil law countries; (2) Reasoned and published court judgments contributing to the adaptation of the law to economic and social change are more frequent in civil law countries than in common law countries; (3) The cost advantage of civil procedure in civil law countries results in superior judicial productivity in all economic sectors except, under certain conditions and in the absence of financial crises, in financial markets (Sect. 5.3).

This evidence, though based on a small sample of countries, suggests that institutional competition between common law and civil law extends to civil procedure. Both legal traditions face the competition of alternative forms of dispute resolution, especially in cases of evident or perceived inefficiencies of formal civil procedure. LOT is contradicted by evidence of many procedural and judicial patterns cutting across the common law/civil law divide. The adversarial system is not a common law privilege, formalism not a civil law dysfunction. Formal rules may increase or save costs, accelerate or delay justice, protect weaker parties against information asymmetries or impede their access to justice by antiquated and costly traditions. The only stark difference congruent with the common law/civil law divide, namely the balance of the role of judges and lawyers in civil procedure, seriously challenges LOT's assumption of the superiority of common law over civil law.

Micro-economic analyses of the opposite incentive effects of cost and time risks of lawyer-dominated civil procedure for stylized financial investors and of judge-managed civil procedure for stylized industrial engineers (Massenot 2010a, b) suggest, however, that common law procedure may have the favor of financial markets, which will please LOT, while procedural efficiency (PE) of civil law procedure is the preferable solution for industrial and industrializing economies, which has not occurred to LOT. In this chapter, I will call the opposite incentive structures of PE in industrial and financial sectors the "procedural efficiency hypothesis" (PEH). Its confirmation would help explain the remarkable convergence of the long-term evolution of GDP per capita of the two common law countries and six civil law countries of our sample found by Boucekkine et al. (2010) in their analysis of the economic impact of codified default rules of substantive contract law, which I will call the "default rule hypothesis" (DRH). Both hypotheses deal with transaction costs, which is the focus of institutional economics (Coase 1988; North 1990). Default rules in contract law reduce the cost of concluding contracts by making them safe against judicial reversal without requiring lawyers' assistance in drafting them. PE reduces the cost risk of their

judicial enforcement. DRH requires control for PE, just like substantive law would be mere "law on the books" without effective enforcement through civil procedure.

In the case of our eight countries, the broader set of indicators of the Louvain questionnaire will permit to test PEH, and, hence, control DRH for both of the opposite incentive structures of PE in industrial and financial economies. The evolution of per capita GDP of the six civil law countries between 1870 and 2008 converges with, and is at times superior to, that of the two common law countries. In dynamic panel analysis covering the period since the major nineteenth century codifications of substantive law, Boucekkine et al. (2010) have shown that a superior number of codified default rules of contract law can compensate a lack of financial center advantage. DRH was confirmed in the six industrialized civil law countries of the sample, while Switzerland's combination of default rule advantage and financial center advantage has permitted it to outperform the US for prolonged periods of time. This chapter contributes data permitting to control these results by evidence of a structurally higher degree of PE in the six industrial or newly industrialized civil law countries (Massenot 2010b), while the financial centers of the UK and the US were able to turn the inverse incentive structure of the comparative inefficiency of common law procedure (Massenot 2010a) into an advantage against risk averse litigants. The evidence suggests confirmation of PEH, which in turn would confirm DRH.

LOT retains its methodological advantage of econometric robustness thanks to the unrivaled size of its samples of countries. But it would do well to descend from the macro-level of its generalizations about the quality of government in common law and civil law countries to the micro-level of judicial or legislative options for providing markets with the institutional safeguards they need in a variety of evident or foreseeable issues and interests. LOT's reliance on global networks of law firms for data collection on time factors of civil procedure raises methodological questions, as it masks the cost factor of the involvement of lawyers. This is understandable, as lawyers in common law countries may be reluctant or incapable to predict their own or their colleagues' billable hours spent for their clients in procedures, of which they largely determine the pace. It would be desirable for both LOT and alternative approaches to engage in cumulative efforts to entrust global data collection to academic institutions of comparative law and economics, and to replace static cross-country regressions by dynamic panel analysis (Sect. 5.4).

5.2 Strengths and Weaknesses of the Lex Mundi Project

The greatest strength of the Lex Mundi project is the econometric robustness derived from the large size of its samples of countries (Sect. 5.2.1). But this strength comes at the price of considerable methodological and empirical weaknesses, some of them recognized, and partially repaired, by LOT and some of them not. Large country samples are difficult to deal with by other than static cross-country analysis, which cannot capture change over time and must often rely on data sources of

Table 5.1 Duration of contract enforcement procedures in mother countries of legal origins (LO), settler countries of English LO, and former colonies affected by the transplant effect

	Countries															
	Mother countries of LO			Settler and trader countries of English LO						Former colonies affected by the transplant effect						
										French LO 50 countries			German LO	English LO 24 countries		
Duration of contract enforcement procedures	France	Germany	UK	Australia	Canada	Hong Kong	New Zealand	Singapore	USA	Africa 22	Asia 9	Latin America 19	0	Africa 14	Asia 10	Latin America 0
Average number of days per country	75	188	288	157	346	201	50	69	250							
Average number of days per region										494	490	482		333	432	

Sources: Author's own compilation and computation of averages in line 2; data on duration of contract enforcement procedures from Djankov et al. (2007), Appendix A

variable or questionable quality. In LOT's case, these problems resulted in a significant number of errors in the coding of countries in terms of political theory, comparative law and legal history (Sect. 5.2.2). The coding errors aggravate a consistency problem posed by the fact that LOT's own data result in average scores of procedural quality and GDP of the English, French and German LO incongruent with LOT's assumed common law/civil law divide. The scores are decisively influenced by the number of countries having received their legal system as colonial transplant after imperial conquest, the smaller this number, the higher the average score of the entire legal origin. If the duration of contract enforcement procedures of only the "mother countries" of LO are compared, France scores best, Germany second and England third according to LOT's own data. If countries affected by the "transplant effect" are included, the German LO scores best with 0 former colonies, the English second and the French third, as it includes more than 50 % of all former colonies of the world in LOT's coding. Unwittingly, LOT measures the transplant effect of the imposition of colonial laws to unreceptive countries rather than the comparative quality of common law and civil law (Sect. 5.2.3). LOT's explanation of the superior scores of German and Scandinavian LO by reverse causation from wealth to institutional quality fails to persuade, as England's case might inspire a similar argument. More convincing are dynamic panel analyses of the quasi-natural experiments of different trajectories of legal and economic histories in divided countries such as China, Germany and Korea (Sect. 5.2.4).

5.2.1 Econometric Robustness Based on Large Samples of Countries

LOT's samples of 106 countries in the Lex Mundi Project of 2002 and of 129 countries in the 2007 study are large enough to cover all legal origins, regions of the world and stages of development. Smaller samples, such as the eight countries in this paper, invariably face objections of small sample bias and selection bias (Docquier 2012, Chap. 2), however convincing the arguments for the economic impact of institutions on economic development in such paradigm cases may be. Large samples convey econometric robustness and, hence, have greater weight in economic discourse. LOT's regressions of data from up to 150 countries have inspired the World Bank IFC "Doing Business" Reports since 2000 (World Bank 2000, 2012).

5.2.2 *Problems of Static Analysis, Biased Data Sources and Defective Coding of Legal Origins*

Of course, it is difficult to measure the impact of institutions on growth in so many countries other than by static cross-country analysis, which cannot capture legal change (Schmiegelow 2006; Armour et al. 2007; Boucekkine et al. 2010; Deakin and Sarkar 2011; Docquier 2012; Kawai and Schmiegelow 2013, Chaps. 2, 3, 6). Also, the degree of reliability of the countries' own official sources of data varies with their number, and LOT's alternative choice of international networks of law firms as data sources is itself open to objections of bias at least in the field of civil procedure, since lawyers are crucially involved as actors in that field. Moreover, with such a large number of countries, the coding of countries in terms of legal theory, comparative law and legal history is inevitably superficial, resulting in a high incidence of errors (Dam 2006a; Schmiegelow 2006; Boucekkine et al. 2010, Chap. 3).

In fairness, it must be acknowledged that in its second (2007) paper on civil procedure, LOT began addressing at least the first of these weaknesses. While defending cross-country analysis with the argument that the impact of legal origins on growth has been stable since their transplant by imperial powers to former colonies, LOT nevertheless recognized the failure of this method to capture the effect of legal reforms (Djankov et al. 2007). For 32 of the 129 countries, the authors of the paper conducted panel analysis for short times series (3–5 years before and after the reform) for changes in variable creditor rights in both common law and civil law countries during the period of 1978–2004 and their effect on the ratio of private credit to GDP. Although they did not analyze these reforms in any detail permitting an evaluation of targets and effects as did Boucekkine et al. (2010) in the case of codification of default rules in contract law or Kawai and Schmiegelow (2013, Chap. 15) in the case of reforms triggered by the Asian financial crises of the 1990s, LOT's first move from static to dynamic analysis is an encouraging sign of methodological progress.

The same paper illustrates, however, a more fundamental problem, i.e. LOT's generalizing association of civil law with government control of the business environment and inferior economic performance. That association is essentially based on a political evaluation of the role of the state in mercantilist phases of French history. It ignores the liberal phases of the *Second Empire* and the Third Republic as well as the defining role of economic liberalism in Germany at the time of the codification of German civil law at the end of the nineteenth century, in postwar West Germany and in united Germany since 1990 (Schmiegelow and Schmiegelow 1975; Boucekkine et al. 2010). It also turns a blind eye at the massive state intervention in the economic history of common law countries, such as nationalization of banks and enterprises in both the UK and the US as well as regulations limiting the freedom of financial markets as rigorously as the Glass-Steagall Act of 1933 and the Dodd-Frank Act of 2010 in the US (Schmiegelow and Schmiegelow 2013, Chap. 4). The generalization of civil law as a regime of state

control and the assumption of superior economic quality of common law appear confirmed only with three selective foci: i.e., first, only in LOT's defective coding of more than 50 % of the sample as of French LO; second, only if the much smaller group of countries of English LO is compared with those of French legal origin rather than with the German LO, and, third, only if the economic quality of LO is measured in comparative averages (mean and median) of the logs of GDP of all countries of English and French LO.

Indeed, the group of countries coded as French LO is the largest with 65 countries or 50.3 % of the sample of 129 and, partly due to the incorrect (Dam 2006b) inclusion of most Latin American countries, has the greatest share of developing countries with unbalanced economies and problems of access to justice. Countries coded as of English LO, including a smaller number of struggling developing countries such as Nigeria, Sierra Leone, and Zimbabwe, are only half as numerous with 30, or 23 % of the sample. Only 18 countries in Central Europe and East Asia, or 13 % of the sample, are coded as of German LO and the average GDP of the group is decisively influenced by the high levels of performance of Japan, South Korea and Taiwan, whose coding as of German LO is doubtful (Schmiegelow 2006; Boucekkine et al. 2010; Kawai and Schmiegelow 2013). Not surprisingly, then, are GDP scores for the English LO superior to the French LO. Equally unsurprising, but intriguing for LOT's generalization of all civil law as economically inferior, however, is the fact that the German LO scores higher than the English.

The authors do recognize this problem. They acknowledge that the superior average economic score of the German LO is not a mere statistical anomaly, but confirmed by findings of stronger creditor protection not only in substantive law but also in civil procedures of contract enforcement. Indeed, in this area of much broader economic significance than the narrow case-types base of tenant eviction and check collection, they find that the average number of calendar days required to enforce a contract of unpaid debt worth 50 % of GDP per capita in Germany is only 184 as compared to 288 in the UK and 250 in the US (Djankov et al. 2007, Appendix A). Enforcement procedures in most of the other countries of German LO in Boucekkine et al.'s sample of eight developed and newly industrialized countries are even shorter than in Germany: 60 days in Japan, 75 in South Korea, 170 in Switzerland. Taiwan's 210 days are more than Germany's, but still less than those of the UK and the US.

5.2.3 The Challenge of Inconsistency and an Unintended Measure of the Transplant Effect

What is more, if we assume—following LOT—that France as the mother country of the French LO may have some significance as a paradigm, it defies LOT by appearing, in Djankov et al.'s own table just cited, in the top group of procedural speed with just 75 days. This is at least one indication that French civil law is not

necessarily always guided by state control, but as scholars of legal history and comparative law often emphasize (Zimmermann 1996; Robaye 1997; Boucekkine et al. 2010), can be outstandingly focused on private autonomy of contracting parties and creditors' interests.

The striking difference between the superior score of civil procedure for contract enforcement in the mother country of the French LO and the inferior average scores of all 65 countries coded by LOT as of French LO, i.e. mostly former Spanish, Portuguese and French colonies, raises the question of the "transplant effect" (Berkowitz et al. 2003). While LOT uses the imperial histories of conquest and colonization as an argument to avoid the objection of reverse causality of wealth leading to superior institutions rather than institutions to superior wealth as in institutional economics (La Porta et al. 1997, 1998; Docquier 2012), Berkowitz et al. have shown that such imperial imposition of laws to unreceptive countries results in structural impediments to broad-based economic development, measurable as a negative transplant effect. Any one econometric measure of that effect such as attempted by Berkowitz et al. may not do justice to change in receptiveness over time such as reported by Badami and Chandu (2013, Chap. 7) in the case of India. The difficulties of cross-country analysis will further increase with autonomous legislation or judicial rulings after independence overlapping asymmetrically with continued validity of colonial transplants such as reported by Deakin and Sarkar (2011) for the case of post-independence Indian labor law and Bakandeja (2012, Chap. 16) for the case of mostly francophone member states of the *Organisation pour l'harmonization en Afrique du droit des affaires* (OHADA).

Hence, the evidence collected by Djankov et al. (2007) in the area of contract enforcement, the most crucial for all market economies, leads to conclusions on the quality of English, French and German law quite opposite to those drawn by LOT for the groups of countries it codes (misleadingly as it turns out) as of English, French and German LO. The differences in the average efficiency of civil procedure of these groups of countries are primarily characterized by the presence or absence of various and changing degrees of the transplant effect. This becomes immediately obvious in a simple exercise, i.e. by comparing the average numbers of days required for enforcement procedures in mother countries of LO as well as in countries developed by British settlers or traders, who brought English common law with them, with the average numbers of days in former colonies affected by the transplant effect in Africa, Asia and Latin America (Table 5.1).

France's outstanding 75 days are "drowned", as it were, by averages of about six times as many days in 50 countries coded by LOT as of French LO in Africa (494), Asia (490) and Latin America (482). The UK's less impressive 288 days are "improved" by the average score of the four settler countries Australia, Canada, New Zealand, and the US and the two originally uninhabited islands Hong Kong and Singapore which developed from English warehouse economies in the nineteenth century (Schmiegelow 1991; Lee 1960) to major financial centers as seedlings of the City of London. And the record of the English LO is less "submerged" by the scores of only half as many countries with transplant effect as the French in Africa (333) and Asia (432). Of course, no Latin American country is coded as of

English LO. And among the countries coded as of German LO, there is no former colony affected by the transplant effect. Japan is recognized as a paradigm of voluntary reception of various foreign legal patterns in a comparative law design (Berkowitz et al. 2003; Schmiegelow 2006; Boucekkine et al. 2010). South Korea and Taiwan have been Japanese colonies living under Japanese law from 1910 and 1895, respectively until 1945, but they both created their own autonomous legal systems since then. South Korea adopted a new code of civil procedure in 1960 and Taiwan reenacted the Chinese code of civil procedure of 1930 with some minor modifications in 1950 after the Kuomintang's withdrawal from Mainland China to Taiwan (Boucekkine et al. 2010, Chap. 3).

One might well say that what LOT measures with its impressive econometric arsenal is not the comparative quality of LO in the sense of the original procedural laws of the mother countries, but, unwittingly, the impact of various degrees and aggregations of the transplant effect. Inevitably, varying with the very different number of former colonies in each group, the impact is greatest in the group coded as French, less so in the English group, and absent in the group coded as German. Djankov et al. (2002, 2007) come close to admitting this unintended result. They explain the superior score of the German and Scandinavian LO by the fact that the countries of these two groups are on average "wealthy" countries. Indeed, they are, just as the English and French LO would be, if former colonies affected by the transplant effect were not counted.

Djankov et al. (2002) seem to recognize this implicitly when they conclude that the transplantation of foreign laws is not the best method of legal reforms. This conclusion is as easy to agree with as their advocacy of alternative dispute resolution (ADR) for developing countries, which have yet to build or reform their judiciary autonomously. But is does not support LOT's generalizations on the comparative quality of common law and civil law.

5.2.4 Reverse Causation or Quasi-Natural Experiment?

Djankov et al. (2007) attempt to explain the German and Scandinavian scores by assuming reverse causation, where legal development follows financial development. However, their explanation is spurious at first sight, since the scores of the UK and the settler or trader countries Australia, Canada, Hong Kong, New Zealand, Singapore and the US could similarly be explained away by wealth, and perhaps with more justification. Inversely, Boucekkine et al. (2010) have shown that Germany and Japan were financially backward countries when they joined the civil law codification movement in the nineteenth century, and that their new contract laws had a measurable impact on the long-term evolution of per capita GDP since then. We were able to consider the divided country histories of post-war China, Germany and Korea with competing legal and economic systems as quasi-natural experiments in counterfactual analysis (Chap. 3).

Further refinements of such quasi-natural experiments may be needed to understand the causal effect of institutions for economic development (Docquier 2012, Chap. 2). But it is hard to see how LOT can improve its methodology while maintaining its three major deficiencies explained above: the focus on comparisons between English and French LOs, the defective coding of the large majority of countries affected by the transplant effect and still struggling with unbalanced economies as of French LO, and the generalization of civil law as state-centered and economically inferior. Solving the consistency problem posed by the scores of the group of countries coded as of German LO or by the scores of the mother countries of English, French and German LOs remains a serious problem for LOT. More accurate coding of legal origins will be a necessary first step to solving it, increasing the number of indicators a second, and a broader move from static cross-country analysis to dynamic panel analysis a third.

5.3 Raising the Number of Indicators of Procedural Quality and Judicial Supply

I propose to extend the number of indicators of procedural quality beyond LOT's single criterion of formalism to eight categories of rules and structures of civil procedure, of institutional supply and of efficiency of justice affecting access to justice as well as the quantity and quality of judge-made law. The selection of these categories follows the design of the Louvain Questionnaire. The eight categories comprise a total of 55 indicators. They combine basic rules and structures of civil procedure or alternative dispute resolution drawn from sources of comparative law and sociology of law with indicators of judicial supply and efficiency of justice similar to those used by CEPEJ in its yearly reports. No single one of these indicators can account alone for significant degrees of judicial efficiency and access to justice. But each of them constitutes a factor increasing or reducing the cost or duration of civil procedure. Some of them affect judicial supply or the pace and quality of the evolution of law directly. Others can serve to control results.

The Louvain Questionnaire was designed to identify the presence or absence of procedural rules and judicial structures of a country as far as possible by the year of their codification or establishment. The design is similar to the one used by Boucekkine et al. (2010, Table 1) to indicate the presence or absence of codified default rules of contract law for the ten most important contract types in eight civil law and common law countries. While that paper detected the economic impact of such contract rules by econometric analysis based on panel data inference over prolonged periods (1870–2008), it covered only substantive law, though its most important area economically. As stated in Sect. 5.1, substantive law "on the books" would be dead letter without transformation into applied, practiced law, ideally in a legal process continuously evolving through published judicial rulings. Such transformation is the function of procedural law and judicial or ADR institutions

operating under the shadow of the law. For that function to be effective, access to justice at low cost and without delay is required. Hence, to control the results of Boucekkine et al. in their analysis of substantive contract law for PE, data on procedural law and judicial or ADR institutions in the same sample of eight countries and the same prolonged periods are needed. The purpose of this chapter is to gather such data.

The first of the eight categories concerns basic rules and structures capturing the most distinctive features often referred to in generalizations of the common law/civil law divide. As it turns out, rather than distinctive, some of these features are common to civil law and common law. Others distinguish one or the other country without being common to either common law or civil law. The only distinctive common law/civil law divide is counterintuitive and defies LOT's generalizations. It concerns the balance of the roles of judges and lawyers as providers of legal knowledge or as managers of the pace of the procedure, with prominent authors of reform proposals in the UK and eminent American scholars of comparative law pointing out lower patterns of efficiency, adaptive functionality and judicial productivity in the UK and the US than in France and Germany (Sect. 5.3.1). Not surprisingly, therefore, out-of-court settlements, the second category, acquire the greatest importance in the UK and the US, followed by the Asian countries of the sample, then France and Switzerland, and the least in Germany (Sect. 5.3.2). The third category, "Status and pay of judges", combines confirmations of cherished popular perceptions of aristocratic judges in the UK and elected judges in many States of the US—as well as most Cantons and the Federal Supreme Court of Switzerland—with evidence of professional judges in public service not only in most civil law countries but also increasingly so in the modernizing judiciary of the UK as well as in the Federal court system and a number of states of the US. Comparative government analysis reveals that separation of powers is sharper, judicial independence greater, and hence, the risk of corruption lower, in the mother countries of civil law countries than in the UK and the US. Defying LOT's most basic generalizations of common law as judge-made law and civil law judges as mechanistic appliers of codes, French and German judges have become more prolific contributors to the legal process than their American and English colleagues (Sect. 5.3.3). The fourth category, "Status and pay of lawyers" indicates that in both common law and civil law countries of our sample, lawyers need both academic education and practical training to qualify, and that they consider themselves to be in the service of the law. American and English lawyers distinguish themselves, however, by the remarkable feat of understanding their profession as a business at the same time. In the matter of fees, LOT is challenged by an Anglo-French LO/German LO divide. Lawyers of the former cross section of LO's plus Japan charge fees per hour negotiated with the client, whereas in countries of German LO (without Japan) set lawyers' fees by law according to descending schedules of percentages of the matter in dispute. Consequently the cost of lawyers' services is lower and, most significantly, more predictable in the latter group, an important indicator of access to justice (Sect. 5.3.4).

Indicators in the fifth category, "Cost and fee allocation in civil procedure", confirm this intermediate result, except that the UK joins most countries of the German LO by the rule that the losing party pays all court costs and the winning party's lawyers' costs. This rule eases access to justice for parties with meritorious causes and modest means. France, Japan, Taiwan and the US leave each party with their own lawyers' costs. In the US, this may result in the winning party having to pay 100 % or more of the proceeds of its victory to the lawyer. All countries in this group, except the US, provide palliatives against such severe outcomes by leaving it to the judge's discretion to award the winning party reimbursement of its costs as damages or by providing legal aid for indigent parties. An important potential palliative against the particular hardships of the "American cost rule" could be the frequent practice of class actions in the US, were it not for their transformation into a "business model" for lawyers, allowing them to take the "lion's share" of the proceeds (Sect. 5.3.5). The hypothesis of a counterintuitive efficiency divide between common law and civil law for seekers of judicial relief is confirmed in the sixth category, "Density of judicial structures". Whereas the public supply of courts and judges per 100,000 inhabitants in the mother countries of civil law and Switzerland is superior to that in the UK and the US, the latter score by their superior number of lawyers (Sect. 5.3.6). Control by category six, "Comparative litigation densities", not only in Germany, but also in France and South Korea further sustains the hypothesis. The French, Germans and Koreans access their courts in numbers superior to those of Americans and the English and Welsh (Sect. 5.3.7). The seventh category "Duration of civil procedure", tests the hypothesis of a faster pace of proceedings managed by professional judges than those determined by lawyers. It is confirmed when controlled by the CEPEJ and NCSC indicators of clearance rate and disposition time. Germany scored with a clearance rate above 100 % in 2006 according to CEPEJ data, and disposition time is below 200 days in all civil law countries of our sample except Taiwan, as confirmed by LOT's own data (Sect. 5.3.8).

5.3.1 Basic Rules and Structures of Civil Procedure

In most civil law countries of our sample, civil procedure was codified by and large at the same time as the codifications of substantive law (Boucekkine et al. 2010). The French *code de procédure civile* (CPC) was adopted in 1806, the German *Zivilprozessordnung* (ZPO) in 1879, the Japanese *Minjishosho-ho* (MJSSH) in 1890, and the Korean and Taiwanese civil procedure acts in 1960 (KCPA) and 1950 (TCCP) respectively. Switzerland adopted a national code of civil procedure only in 2011, but was able to rely on pre-existing cantonal rules of civil procedure (Brunschweiler et al. 2011), such as the *Zivilprozessordnung* of the City of Basel of 1875, for the transformation of its modern commercial code of 1881 and its civil code of 1912 into practiced law. English common law originated within a century after the Norman Conquest (Baker 2002) and was, in many ways, a French product

(van Caenegem 1988). The conquest by William the Conqueror, the "violent ruler of a turbulent minor principality… of France" (van Caenegem 1988 at 9), was described by Maitland, the classical historian of "English law before Edward I" (Pollock and Maitland 1895), as a major catastrophe, which determined the whole future of English Law. William and his Angevin successors' sense for strong government transformed the early feudal court of the Anglo-Saxon kings into effective departments of state and a unified judicial system (Baker 2002). Procedural rules, especially trial by oath, ordeal or battle, were developed before substantive rules. By the time of Henry II Plantagenet (1154–1189), the King's "Bench" was established at Westminster, and the extremely formal and imperious writ system institutionalized (Baker 2002). As a palliative against such common law rigidity, the equity (Chancery) courts were established in the fifteenth century with the authority to apply principles of equity based on alternative sources, such as Roman law, natural law and principles of good faith in order to achieve justice (Worthington 2006). In the course of the nineteenth century, the writ system was several times simplified, but retained the style of archaic formalism. Only the Civil Procedure Rules of 1998 based on Lord Woolf's Access to Justice Report of 1996 modernized English civil procedure by abolishing the writ system and offering procedures at more reasonable cost and with more reasonable speed (Woolf 1996), unfortunately too late to count significantly in controlling the long run panel analysis of the English case in Boucekkine et al. (2010) for PE. The founders and settlers of the US brought the English rules in their eighteenth century version with them, and these continued to be applied in numerous variations in those states which did not legislate civil procedure in civil law style in codifying statutes, such as the California Code of Civil Procedure of 1872 (CalCCP). The latter influenced the drafting of the Federal Rules of Civil Procedure of 1938 (FRCP), which, in turn, have exerted a unifying influence on state civil procedure rules ever since.

These histories of precedence or parallelism of procedural law in relation to substantive law predestines our sample for the control of dynamic panel analysis of the economic effects of substantive law by indicators of procedural law, judicial efficiency and access to justice. The court systems charged with applying substantive law under these procedural rules were created in France by the *loi de l'organisation judiciaire* of 1790 and subsequent reforms in 1940 and 1995, in Germany by the *Gerichtsverfassungsgesetz* of 1879, in Japan by the *Saibansho-ho* of 1890, in Korea by the Court Organization Act of 1949, in Switzerland by cantonal laws such as the *Gerichtsverfassungsgesetz* of 1911 of the Canton Zürich, in Taiwan by the reenactment, in 1950, of a modified version of the Organic Law of the Courts of China of 1909. In the UK, the medieval institutions of common law jurisdiction were reformed by the Judicature Acts of 1873 and 1875 and the Appellate Jurisdiction Act of 1876, in the US by the Judiciary Acts of 1789 (Supreme Court, Federal Circuit Courts and Federal District Courts) and 1891 (Federal Courts of Appeal) on the national level and by state constitutions or laws on the state level, such as the Constitution of the State of New York of 1846.

Data on the evolution of per capita GDP in constant 1990 International Geary-Khamis dollars (Maddison 1995, 2001) used by Boucekkine et al. (2010) for their

panel analysis of substantive contract law are available only from 1870 on for most countries of our sample. I propose to follow their example of indicating the presence of the relevant procedural rules and judicial institutions in France, the UK and the US by the year 1870 in Tables 5.2, 5.3, 5.4, 5.5, and 5.6 as a starting point for the control of their panel analysis of codified default rules in contract law for PE. For the other five countries I propose to use the years 1879 for Germany, 1890 for Japan, 1960 for post-independence South Korea, 1875 for Switzerland taking Basel as a cantonal paradigm, and 1950 for Taiwan.

Unlike popular discourse would have it, the most basic difference between common law and civil law rules of civil procedure is not the adversarial system of the common law descended from the medieval trial by ordeal or battle. Just like common law procedure, the French CPC, the German ZPO, the Japanese MJSSH, the Korean KCCP, the Basel ZPO and the Taiwanese TCCP are governed by the principle of parties' domination of the initiation, the subject and the ending of the procedure (von Mehren 1982; Langbein 1985; Weber 2002; Deguchi and Storme 2008). The plaintiff states his claim and the defendant declares whether he accepts or rejects it. Both are left with the task of submitting the facts they wish the court to consider and they carry the burden of proof of these facts. They can withdraw, or accept, the claim and agree to settle in court or out-of court at any moment. If they do not settle, they request a court ruling and submit opposing drafts for the tenor of that ruling, i.e. the plaintiff, most often, the award of the amount in controversy for himself and cost allocation to the defendant, the defendant, adversely, the dismissal of the suit and cost allocation to the plaintiff. LOT sometimes mistakenly assumes that public prosecutors are involved in all civil law countries in civil as well as criminal procedure to represent the interests of the state. Indeed, there is a long French tradition first of the King's representatives and then of the procurator of the Republic to intervene under certain conditions in civil and commercial litigation if the public interest or the *ordre public* is touched (Marin 2006). This tradition has found its way into procedural codes of numerous civil law countries by colonial transplant or voluntary adoption. But, then, so it has into American civil procedure, such as in § 415.20 (b) CalCCP, which requires notice to the Attorney General in action based on pollution or adverse environmental effects. An indicator of how massive intervention of American Attorneys General in civil litigation can get, was the $25bn deal forced upon the five largest American banks on February 9, 2012 by a joint effort of the US Attorney General and 49 state attorneys general to solve problems of foreclosure procedures of subprime mortgage borrowers (US Department of Justice 2012; Schmiegelow and Schmiegelow 2013, Chap. 4). The only country of our sample recognized by Djankov et al. (2007) as having 0 inquisitorial elements in its civil procedure, is Germany. Again, there is no clear common law/civil law divide, even in LOT's own data, as far as the much-cited adversarial system is concerned.

This is confirmed by the most authoritative American sources of comparative law, not only for Germany, but also for France. Arthur von Mehren, the prominent postwar scholar of comparative law at Harvard, wrote: "The civil procedure systems of France, Germany and the United States were—and remain—adversarial"

(von Mehren 1982 at 361, n. 3). John Langbein, the eminent historian of common law at Yale, agrees with von Mehren's categorization, although he emphasizes the more active role of the civil law judge in the non-partisan conduct of fact gathering, which he finds superior to the "wastefulness" and "truth-defeating distortions incident to our (US) system of partisan preparation and production of witnesses and experts" (Langbein 1985 at 824, note 4). He concedes that this particular aspect of non-partisan fact gathering by the judge in German civil procedure might be called "non-adversarial". In this last respect, I am inclined to disagree considering the above-mentioned maxim of parties' domination of German civil procedure. The state only supplies "the rules of the game of the litigation" (Weber 2002) and the legal knowledge of the judge. While the judge filters the facts submitted by the parties into contested or uncontested, and legally relevant or irrelevant categories, conducts the hearing of witnesses and discusses the legal significance of submitted facts and evidence with the parties, the theme of the evidence is defined, and controlled, by the party who named the witness as proof. To be sure, the judge is, and must be, non-partisan, or face the risk of appellate reversal, but the control of the evidence procedure (*Beweisverfahren* in German) by the parties remains adversarial. The functional advantages of a more active role of the judge in non-partisan fact gathering and in organizing the pace of procedure have been recognized and emulated in the US in so-call Big Cases with complex constellations of facts and multitudes of plaintiffs such as in class actions. This trend has not led, however, to any change in the still prevailing American theory and popular perceptions of America's adversarial system (Langbein 1985). Similarly, Lord Jackson's review of civil litigation costs in the UK (Jackson 2009) contained a strong plea for a more active role of British judges as a way to improve the efficiency of the country's justice system. Hence, in terms of adversary systems in civil procedure, the civil law/common law divide exists more in perception than in reality.

Nor do indicators 3, 4, 5, 6, 11, 12 and 14 in Table 5.2 on basic rules and structures of civil procedure suggest such a real divide. Line 3: Judges have been applying codes in both legal traditions, in the civil law countries of our sample ever since their civil, commercial and procedural codes came into force, in the UK and the US at least since their major codifying statutes on contract law were enacted for the first time in 1893 (UK) and 1953 (US) (Boucekkine et al. 2010 Table 1, and Chap. 3). Line 4: Judges have nonetheless also been finding the unwritten law, not only in common law countries, but also in civil law countries where judges have been producing judge-made law in the best sense in sometimes hard-won advances against dogmatic positivism clinging to the letter of codified law. These advances are indicated in line 4 by the year of the first seminal court rulings of that kind, in Germany 110 years ago, in France 83 years ago and in Switzerland 54 years ago as reported by Schmiegelow and Schmiegelow (2013, Table 3) on Germany and Japan, by Malaurie (1980) on France, and by Uyterhoeven (1959) on Switzerland, long enough to matter for the control of results in Boucekkine et al.'s panel analysis. In the three Asian countries of our sample, pragmatic judicial reasoning has been a part of their cultures long before 1870 (Haley 1998; Glenn 2004; Fujita 2008). Lines 5 and 6 defy LOT's generalizations about common law procedure as oral and

civil law procedure as written. Claims must be filed in "writs" in common law countries as explained above, whereas in civil law countries the whole (civil) procedure up to judgment may be viewed as essentially a "series of oral conferences" (Kaplan 1960; Kötz 1982a, b) as provided for in all civil procedure codes cited above. Such conferences are held between the judge and the parties in the "tone of routine business meetings" (Langbein 1985) to debate the correspondence of the facts submitted by the parties with the law relevant for the claim in dispute. In that way civil procedure in civil law countries avoids the surprises and *coups-de-théatre* so typical of the concentrated one-day trial in the UK and the US (Langbein 1985; Maxeiner et al. 2010). Written documents, deeds, certificates, letters serve as the most cogent types of proof in both legal traditions. In the best cases, judicial rulings are issued in writing so that their reasoning in terms of fact and of law can be published in printed or electronic records and serve as precedent, inspiration of jurisprudence or trigger of functional interaction with legislative or executive branches of government in civil law countries as well as in common law countries (Schmiegelow 2006; Schmiegelow and Schmiegelow 2013, Chap. 4). In its strategic directions for legal and judicial reforms, the World Bank's Legal Vice Presidency recommends written reasons of judicial rulings as an essential requirement enhancing "the quality, predictability, consistency and growth of jurisprudence" (World Bank Legal Vice Presidency 2003 at 3). Line 11 indicates the well-known fact that lawyers have a unified role of advice and representation in court in all civil law countries as well as in the US, while Line 12 acknowledges the exclusive, but costly, English tradition of a two-tiered structure of solicitors and barristers (Elliot and Quinn 2007). Line 14 shows that the procedural economy of default judgments against a party failing to appear at a scheduled court hearing is a feature of both civil and common law traditions (Articles 471 ss Code de procédure civile, §§ 330 f. ZPO, § 244 Minjishosho-ho, Part 20 UK Civil Procedure Rules, Siegel 2005).

The remaining seven indicators in Table 5.2, however, represent the procedural differences between common law and civil law most crucial for the analysis of comparative efficiency of, and access to, justice. If combined, these indicators reveal very different balances, which the two traditions strike between the role of judges and lawyers as providers of legal knowledge relevant for the issue in controversy and as managers of the pace of procedure. In lines 1, 7, 9 and 13 they are listed in blue as characteristic of civil law, in lines 2, 8, and 10 they acknowledge in red the most traditional and cherished features of common law. Line 1 introduces the principle *jura novit curia* (The Court knows the law). Kaplan et al. (1958 at 1224–1225) recognize this maxim as the "overriding principle of German law". The judge is bound to apply the law without prompting from the parties or face the risk of appellate reversal. The advantage of this principle in John Langbein's view is that it limits the effects of any disparity in the quality of legal representation (Langbein 1985). The legal knowledge of the academically trained judges is supplied as a public good. Lawyers representing the parties may raise questions of law and engage in debate with the judge on issues of interpretation of codes, doctrine or precedent, but there is no burden of proof for the parties on points of law. Whereas this rule is the most distinctive maxim of civil procedure in most

civil law countries, it is not part of the English legal tradition, which assigns responsibility for the correct legal analysis of the case to the parties' lawyers (Kaplan et al. 1958; van Rhee 2005). Line 7 indicates an active role of the judge in managing the pace of procedure. Line 9 reflects that this involves a technique of issue narrowing (*Relationstechnik* in German, Rüßmann 2004), which separates both legally relevant from irrelevant, and uncontested from contested facts, avoiding costly and time-consuming efforts of parties, and their lawyers, to accumulate irrelevant or unnecessary evidence (Langbein 1985; Maxeiner et al. 2010). The efficiency advantage of this technique becomes immediately apparent if compared with the inclination of American litigators characterized by Deborah Rhode as "to leave no stone unturned, provided, of course, they can charge by the stone" (Rhode 1984). John Langbein puts the effect in a nutshell immediately relevant for the economic analysis of law: "avoidance of waste" (Langbein 1985 at 846).

LOT has remained oblivious to the economy of these basic rules of civil law. Although there has been what Langbein describes as a "surprisingly rich English language literature on German civil procedure" (Langbein 1985 at 826, note 8) since the 1950s, LOT's major restatement in 2008 still defends its focus on the negative aspects of the French LO, by default as it were, claiming that "less has been written about German law (than about French law)" (La Porta et al. 2008 at 304). What it does recognize however is what it perceives as a German advantage in terms of efficiency of debt collection, presumably thanks to the *Mahnverfahren*, Germany's version of summary debt procedures. But as line 13 indicates, summary debt procedures are a feature of all five civil law countries in our sample, while they are absent in the two common law countries.

In contradistinction to the civil law maxim of *iura novit curia* in line 1, line 2 highlights the role of the common law judge as a mere referee in procedures dominated by lawyers both in jury trials and bench procedures. Whatever the quality and extent of his actual legal knowledge, the judge is expected to act with "calculated amateurism" (Langbein 1985 at 852). In the UK, the Judicature Acts of 1873 and 1875 relieved the parties from the formal obligation to quote and document the legal rules supporting their arguments (Hazard and Dondi 2006), but the comparative passivity of common law judges has remained an issue of the debate on the cost of civil procedure in the UK and the US, most recently in Lord Jackson's Review of Civil Litigation Costs of 2009 (Jackson 2009).

Consequently, line 8 indicates the dominant roles of lawyers controlling the pace of procedure in the UK and the US. As they leave "no stone unturned" in pretrial discovery of open-ended duration until they reach a settlement or begin coaching their witnesses or experts for the concentrated final drama of their clients' day in court, the procedure is distinguished by an incentive structure in terms of lawyers' fees (Reimann 2012). The result has been an in-built slowness and priceyness of common law civil procedure ever since the days of the Westminster King's court (Baker 2002; Danziger and Gillingham 2003; Woolf 1996; Jackson 2009). In terms of legal philosophy, the question of the compatibility of such a system with the Magna Carta promise: "To no man will we sell, or deny, or delay, right or justice" inevitably arises. Since 1975, this traditional pattern has been enhanced in the US

Table 5.2 Basic rules and structures of civil procedure

Rules/Structures \ Countries	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England, Wales	US
1. "Jura novit curia" rule as a public good ("The court knows the law", there is no burden of proof for parties on questions of law)	(1806) >1870	1879	1890	1960	1875 (Basel)	(1930) 1950	0	0
2. Judges as "referees" in trial dominated by lawyers (may take expert testimony on questions of law)	0	0	0	0	0	0	(12^{th} century) > 1870	(1840s) > 1870
3. Judges applying Codes	(1804) >1870	1861	1896	1958	1883	(1929) 1950	1893	1953
4. Judges "finding the (unwritten) law"	1930	1902	>1870	>1870	1959	>1870	>1870	>1870
5. Written procedure	>1870	1879	1890	1960	1875	1950	>1870	>1870
6. Oral hearings	>1870	1879	1890	1960	1875	1950	>1870	>1870
7. Court controlling pace of procedure	>1870	1879	1890	1960	1875	1950	0	0
8. Lawyers controlling pace of procedure	0	0	0	0	0	0	>1870	1938
9. Court identifying relevant facts	>1870	1879	1890	1960	1875	1950	0	0
10. Lawyers engaging in pre-trial discovery	0	0	0	0	0	0	>1870	1938
11. Lawyers in unified role of advice and representation in court	>1870	1879	1890	1960	1875	1950	0	>1870
12. Two-tier structure of solicitors and barristers	0	0	0	0	0	0	>1870	0
13. Summary debt procedures	>1870	1879	1890	1960	1875	1960	0	0
14. Default judgment routine procedure	>1870	1879	0	0	1875	n.a.	>1870	>1870

Legend: The presence of rules or structures is indicated by the year of entry into force of the rules or the establishment of the judicial structures mentioned, preceded by ">" if the entry into force of the rule or the establishment of the structure predates 1870, the starting year of reliable GDP data for dynamic panel analysis; their absence by "0"

Sources: Authors own compilation; table design: Schmiegelow and Schmiegelow (2012)

Table 5.3 A counterintuitive efficiency divide

		Rules of civil procedure					
		Civil law			Common law		
Efficiency		"Jura novit curia" (legal knowledge of academically trained judges as a public good)	Judge separates contested from uncontested facts	Court manages pace of procedure	Judge in passive role of "referee"	"No stone left unturned": Any facts and questions of law raised by lawyers in "pretrial discovery" irrespective of relevance	Lawyers manage pace of procedure
Cost	Low	X	X	X			
	High				X	X	X
Time	Fast	X	X	X			
	Slow				X	X	X

Source: Author's own schematic; table design: Schmiegelow and Schmiegelow (2012)

by what Steven Harper describes as an "obsession with billable hours" (Harper 2013 at 79) in big law firms, the major players in a legal profession achieving more than 2 % of US GDP (Rickard 2010). Table 5.3 sums up the efficiency divide between common and civil law procedure. It may be counterintuitive for LOT. But it is recognized by the most authoritative voices of comparative law and legal reform in the UK and the US.

But then, as a micro-economic analysis of Baptiste Massenot has shown, the passive role of judges as referees of disputes managed by lawyers in common law countries may serve the interests of litigants in financial markets effectively, as they can be assumed to dispose of sufficient resources to take the cost risk of such a procedure while letting that risk deter financially weaker parties from initiating or continuing a controversy (Massenot 2010a). Litigants with greater cost risk aversion such as small and medium engineering firms, however, will appreciate the efficiency advantage of the role of judges as providers of legal knowledge and managers of the pace of procedure, which is made available as a public good in civil law countries (Massenot 2010b). Massenot's micro-economic approach deserves LOT's attention. I will use it as one of the tests of PEH in this chapter.

Distinguishing the inverse relation of the incentive structures of lawyer-dominated and judge-dominated civil procedure should be an important criterion for legal reforms in many developing and emerging countries. They may wish to adapt the composition of legal reforms to the structural conditions of their economies and the projected paths of their development. Switzerland, the only civil law country enjoying both financial center advantage and a competitive industrial sector (Boucekkine et al. 2010, Chap. 3) might be considered as a particularly interesting case study.

5.3.2 *Out-of-Court Settlements and Alternative Dispute Resolution*

Both common law and civil law traditions face the competition of alternative forms of dispute resolution. There is a large spectrum of evident or conceivable patterns of avoidance of formal civil procedure. There are economic, cultural, political and sociological explanations, which focus on concepts of widely defined justice in clear distinction, if not outright opposition, to what civil procedure of any judiciary of whatever legal origin can offer. LOT, as represented by Djankov et al. (2002), prefers, as explained, to assimilate common law civil procedure with the idyllic setting of two neighbors having their dispute settled by a third neighbor. That assimilation raises the question, however, why out-of-court settlements or ADR avoiding the ruling of a common law judge are so prevalent in the common law countries, in the US to the point of what some lament as the "death of the American trial" (Burns 2009). Erhard Blankenburg, the sociologist of law, analyses changing balances between demand for law and judicial supply in line with changes in mentalities, legal needs and judicial structures. Focusing on the Netherlands, a civil law country coded by LOT as of French LO, he describes how the traditional Dutch preference for dispute settlement by arbitration gave way to increased use of the formal court system since the 1980s due to such a change in demand and supply (Blankenburg 2012, Chap. 11). Linn Hammergren, the political scientist, believes, after decades of work in the World Bank's poverty reduction and economic management programs in Latin America, that access to justice can be improved only outside the hybrid legal systems of Latin America and that even ADR, including its cultural variants usually referred to as CDR, hoping to correspond to the needs of indigenous parts of the population, have failed to reduce poverty. She concludes that in many countries with large geographies, small judiciaries and high rates of poverty, justice in the material sense should be the task of dispute preventing public policies in other than legal areas, such as employment and social security (Hammergren 2012, Chap. 14).

In developed or newly industrialized countries it is safe to assume, however, that the most obvious function of out-of-court settlements and ADR is to serve as a palliative for cost and/or time inefficiencies of civil procedure in the formal judiciary. This should at any rate be the criterion from the perspective of law and economics as it is, indeed, for LOT with Djankov et al.'s (2002) strongly stated preference for ADR to formal civil procedure in civil law countries in view of assumed inefficiencies of the latter. Following LOT's law and economics approach to understanding the function of out-of court settlements and ADR as palliatives against inefficient formal judiciaries, I propose to test the counterintuitive efficiency divide between civil law and common law procedure explained in Sect. 5.3.1 and Table 5.3 by indicators of the comparative prevalence or rarity of the use of these palliatives in the eight paradigm countries studied here.

Given the structural cost and time inefficiency of American and English civil procedure described in Sect. 5.3.1 and Table 5.3, there is an inbuilt pressure on

litigants averse to cost risk and time loss to settle out of court. Hence, as attested by CEPEJ (2008 at 136), "the number of judicial decisions per year in England and Wales is relatively limited if compared with the number of cases filed per year", which puts it mildly considering that the numbers reported for 2006 were 46,198 judicial decisions out of 2,127,928 cases filed, i.e. a mere 2.17 %. Jury trials, once thought to be the Magna Carta paradigm of judgment by one's peers, if not one's neighbors in LOT's version, were effectively abolished for civil cases in England and Wales by the Administration of Justice (Miscellaneous Provisions) Act of 1933. In the US, jury trials, once thought to be the normal way of dealing with civil cases, dropped below 1 % of terminations of civil litigation in 2005. Bench trials declined below that point already in 1998 (Galanter and Frozena 2011). Robert Burns at North-Western University laments that the "American trial (. . .), one of our greatest cultural achievements (. . .), seems to be disappearing in one context after the other" (Burns 2009 at p. 1, 2).

This is not a recent phenomenon. The percentage of cases ending by adjudication has never been as high in the US as the figures attested today by CEPEJ for France or Germany. Marc Galanter quotes from a study of litigation in the St Louis Circuit Court from 1820 to 1970 by Wayne McIntosh: "During the first 100 years of the study period, the percentage of cases culminating in a contested hearing or trial remained fairly steady (around 25 to 30 percent). After 1925, though, the average skirted downward into the 15 percent range. (Figures) . . . reveal that the shift from adjudication to bargaining is . . . wholesale and not restricted to any one issue" (McIntosh 1990, as quoted by Galanter 2005 at 1257–1258). In the early 1980s, Galanter, the sociologist of law, was inclined, as a matter of principle, to prefer "justice in many rooms", i.e. decentralized private ordering "in the shadow of the law", social fora, religious courts, and indigenous laws (Line 4 of Table 5.4) as an alternative to what he called the paradigm of "legal centralism" leading to courts overwhelmed by swollen caseloads (Galanter 1981). Three decades latter, his analysis of the "approaching extinction of the civil trial" (Galanter and Frozena 2011) is tinged with worry and thoughts about how the trend could be turned around. From a law and economics standpoint, I submit that average Americans are risk averse enough to look for "justice in many rooms" rather than surrender to the incalculable cost and time dynamics of lawyer-dominated pretrial discovery and trial in American civil procedure. This might have occurred to Djankov et al. (2002), when they emphasized their preference for alternative dispute resolution, but it does not seem to have done so, since their preference is distinctly stated as one for ADR to civil procedure in civil law countries which they assume, wrongly as I argue, to be less efficient than in common law countries.

The vanishing of civil trials in the UK and the US does not reflect any decline of the demand for law in these countries. As reported in Sect. 5.3.7 and Table 5.9, the number of civil cases filed per 100,000 inhabitants is higher in England and Wales (6,440 in the mid 1990s) and US State courts (5,317 in 2010) than in France (4,040 in the mid 1990s), where 75 % of civil cases end by adjudication (Haravon 2010). The evident explanation for the striking gap between demand for law and adjudication in the two common law countries is that lawyers have replaced judges as

prevailing suppliers of dispute resolution. In all cases between litigants with asymmetrical net worth, i.e. the prevailing type of cases, there is an inexorable pressure on the less well-endowed party to settle out of court before the point of financial exhaustion. The billable hours (Harper 2013) of the lawyers dominating the pace of procedure constitute an effective threshold for eventual access to adjudication by trial. The palliative for this predicament is the lawyer-brokered settlement as early as possible in the pretrial stage. The common law/civil law divide in terms of efficiency of formal civil procedure discussed in Sect. 5.3.1 and schematized in Table 5.3 leads straight to the only clear common law/civil law divide in out-of-court settlements and ADR in line 1 of Table 5.4: the prevalence of lawyer-brokered out-of-court settlements in common law countries and their much lower frequency in civil law countries.

The opposite phenomenon is observable in Germany's case. Not only is the German litigation rate the highest in the sample of countries studied here (12,320 filings per 100,000 inhabitants), so that Erhard Blankenburg speaks of "*Prozessflut*" (litigation flood) in his 1998 comparative analysis of indicators of continental European legal cultures. But German litigants also tend to take advantage of predictable and, by international standards, modest cost and fee schedules set by law in order to seek court rulings usable for reference in future litigation or in adjusting their own behavior with a view to avoiding future disputes. German businesses readily accept the institutional supply of commercial chambers at district courts composed of one professional judge and two lay judges of the local business community in single panels categorized by Langbein (1985) as "mixed courts" combining access to "peers" with access to a court ruling written by a professional judge. Specialized first instance labor, social, administrative and tax courts have similar mixed court structures. Although German first instance courts routinely use the first oral conference as well as any subsequent one in the series of oral conferences with the parties described above to suggest amiable settlements, they must provide, if at least one party insists, a written judgment containing the findings of facts and law. Hence Germany is unsurprisingly the country of our sample combining the highest litigation rate (Sect. 5.3.7, Table 5.9) with the lowest demand for out-of-court settlements or other alternatives to formal civil procedure.

Arbitration was institutionalized in the German ZPO of 1879 just as in France's CPC of 1808, Japan's MJSSH of 1890, South Koreas KCCP of 1960, Switzerland's Inter-cantonal Concordat on Arbitration of 1969 preceding the respective provisions of the new Swiss code of Civil Procedure of 2011, Taiwan's TCCP as well as the Arbitration Acts of 1950 of the UK and of 1925 of the US (Table 5.4, line 2). But in contrast to the importance of international arbitration for cross border disputes, national arbitration has played only a minor role in Germany (Stolle 2005). South Korea's high rate of formal litigation in recent decades (7,806 per 100,000, Table 5.9) correlates with a similarly low role of national arbitration (Lee 2010, 1992), whereas in Japan and Taiwan, the prevalence of a functioning relationship pattern in social interaction and economic transactions has been reducing demand for national arbitration along with demand for formal civil procedure (Allen et al. 2009; Glenn 2004; Haley 1998; Katsuta 1996; Nakano 2004; Nakajima

2012). In France and Switzerland, arbitration proceedings have traditionally been, and still are, used more frequently (Delvolvé et al. 2009; Berger and Kellerhals 2007). In both these European civil law countries, incentives for preferring arbitration to formal civil procedure have been, I submit, greater than in Germany. In France, they are the result of what Michael Haravon, who is now a French judge after having been a lawyer in France, England and the US, calls "*une certaine opacité* (a certain opacity) (Haravon 2010 at p. 33) of the cost risk of a lawyer-assisted civil law suit, though in the French case the opacity is certainly not one of such "thickness" as in the UK and the US. Table 5.7 reflects the difference between the French and German cost rules and structures. In Switzerland, which shares Germany's type of cost rules (Reimann 2012), the attraction of an international arbitration system doubtless results from a different incentive, namely the fact that civil procedure in Switzerland remained divided by cantonal particularism until a federal code of civil procedure was finally enacted in 2008.

In the US, both the aversion against massive cost risk of civil procedure and the preference of all businesses involved in interstate trade to avoid the particularism of State laws and practices of civil procedure led to widespread demand for arbitration and to the Federal Arbitration Act of 1925. Fear of destroying valuable business relationships by years of costly adversarial litigation was an added motivation. After the emergence of consumer protection laws in the 1970s, mandatory arbitration clauses were also used by businesses wary of class actions related to the purchase of consumer products, which, in turn, gave rise to academic proposals to ban such clauses (Brunet et al. 2006). In the UK, somewhat comparable cost and time inefficiencies of civil procedure as in the US should have worked as a similar incentive to use arbitration as an alternative mode of dispute resolution. Three consecutive Arbitration acts adopted in 1950, 1975 and 1979 and a large body of case law were supposed to support that incentive. However, as emphasized by Pendell (2010), English arbitration was criticized for being inaccessible to lay users as well as slow and expensive to the point of being described as "litigation without wigs". Only a fourth arbitration act, of 1996, was widely praised, too late to count in the control of long-term panel analysis of DRH for PE as an effective palliative to the structural inefficiency of common law civil procedure in England and Wales.

Mandatory or optional, but court-supervised, conciliation or mediation procedures have a long tradition in most civil law countries of our sample with incentive structures similar to those just discussed in the area of arbitration. Again, they have played the least important role in Germany. While *Gütetermine* (conciliation hearings) are routinely scheduled at the beginning of first instance civil procedures, litigant's preference for a cost and time efficient court ruling prevails in a large majority of cases for the reasons explained in the preceding section. Mediation procedures as ADR are an innovation by a law adopted in 2012 in response to the European directive on mediation of 2008 (Nettersheim 2012), too late to count in the control of DRH for PE. Inversely, mandatory or optional conciliation has a tradition of more than 200 years in France, where the State's interest in relieving the burden of the courts joined the interest of risk-averse litigants in avoiding the cost and loss of time resulting from continued contentious procedure. First

institutionalized by the *loi portant sur l'organisation judiciaire* of 1790, mandatory conciliation procedure for all matters falling under the jurisdiction of the ordinary district courts and justices of the peace attempting such conciliation in practice remained a feature of the French judiciary in various transformations until 1940, when conciliation became an optional way of ending civil procedure. Extrajudicial conciliation emerged in the 1970s with "mixed results" (Gaillard and Edelstein 2000), only to be partially replaced by court-supervised conciliation or mediation by law No. 95-125 of 1995. The most significant impact of these various forms of mandatory or optional forms of ADR on contract disputes has been in the areas of labor, consumer, rental, commercial, and corporate laws (Gaillard and Edelstein 2000). Switzerland's conciliation and mediation procedures reflect more French than German patterns in spite of German-type cost rules that should reduce the incentive for litigants to avoid formal civil procedure. Mandatory conciliation procedures (*Sühnverfahren*) by justices of the peace before the opening of civil procedure has been a cultural heritage from Switzerland's French period as Helvetic Republic from 1798 to 1803, while optional mediation procedures were introduced in 1989 in the French speaking cantons in the field of family law. In 1992, a Swiss association promoting nationwide mediation was established, but as yet there has been no parliamentary majority for the introduction of mediation procedures on the national level (Meier 2002).

In the Asian countries of our sample, conciliation has the deepest cultural roots, beginning as CDR on the village level and continuing through Confucian rulings of Chinese magistrates, the *Naisai* of Edo period and the *Kankai* of Meiji period Japan (Glenn 2004; Lee 2010; Lee TH 1992; Berat 1992; Katsuta 1996; Kobayashi 2012), until modern codifications or special laws institutionalized mandatory and court-supervised conciliation as follows: In Japan, special laws enacted in 1922, 1924, 1926, 1932 and 1942 institutionalized conciliation in housing and farming tenancy disputes, commercial disputes, and debt collection and, finally, in all civil disputes during the war period respectively. Postwar, the Civil Conciliation Law of 1951 formally introduced general conciliation provisions into postwar Japanese civil procedure in all civil matters except domestic relations (Kobayashi 2012). In South Korea, the Judicial Conciliation of Civil Disputes Act of 1990 introduced optional court-supervised conciliation for the first time in all civil law matters. Previously, mandatory court-supervised conciliation had been imposed only in household and lease matters (Sohn 2002). In Taiwan, optional conciliation at the beginning of first instance civil procedure was provided by the TCCP of 1950, Art 420-1 (Chen 2002).

While the cultural attachment of the Japanese to conciliation procedures has been remarkably stable up to, and through, the postwar period in spite of Japan's tremendous rise to leadership in modernity and technology, South Korea and Taiwan underwent a similarly remarkable process of change towards appreciation of civil litigation ending in court rulings (Berat 1992; Pistor and Wellons 1999). In these two newly industrialized East Asian countries, the same inverse relationship between rising litigation propensity and declining reliance on ADR as in Germany since 1879 seems to be emerging.

Since English common law and its adversarial jury trials are widely considered as a unique cultural achievement both in the UK and the US (Baker 2002; Burns 2009), it is not surprising that court-mandated or -supervised conciliation has not emerged as alternative dispute resolution on cultural grounds. Hence, Line 3 of Table 5.4 indicates another distinctive common law/civil law divide.

However, reflecting Marc Galanter's seminal article on "justice in many rooms" (1981), Line 4 of Table 5.4 indicates a diversity of ADR patterns based on local cultural traditions not only across LOT's divide between common law and civil law, but also as an American particularity within the English LO. The laws and procedures which the countless churches of indigenous or immigrant background coexisting in the US have given themselves are perhaps the best example. It illustrates the double nature of what Galanter calls centrifugal legal orders based on diverse confessional traditions (Line 4 b) but operating in some degree of compliance with, or in Galanter's words, "in the shadow" of, the "central" (State or Federal) laws and procedures (Line 4 b). Of course, complex church-state relations have a long history in England and European civil law countries as well. But the American pattern of "justice in many rooms" is certainly an important deviation from the English case because of the multitude and diversity of such centrifugal institutions. For econometric analysis, it would be important, however, to find a way of distinguishing the cultural, sociological or just "local" motivation for seeking this type of ADR from the economic incentive for using it as a palliative against the inefficiencies of formal civil procedure in the US.

One way towards building hypotheses on this problem would be to compare the American paradigm of "justice in many rooms" to somewhat similar, though far from identical patterns in civil law countries. For example, the American paradigm is much less of an exception if compared to Switzerland with its tradition of local direct democracy and diversity of languages, religious confessions, cantonal histories, and, not the least, cantonal civil procedure. The three Asian countries of our sample as well might invite analysis in Galanter's terms for the same reasons discussed by the large literature cited above in connection with arbitration and conciliation procedures (Allen et al. 2009; Berat 1992, Glenn 2004; Haley 1998; Katsuta 1996; Kobayashi 2012; Lee 2010; Lee G 1992; Nakano 2004; Nakajima 2012, Chap. 12). Again, the Japanese attachment to settle disagreements outside the modern civil courts, which pervades both internal and external relations of households, neighborhoods, villages, businesses, associations, political parties, etc. is an outstanding example. Because of its long history and because of its perceived contrast to Japan's concomitant modernity, this attachment has attracted a far larger sociological literature than Galanter's American paradigm of "justice in many rooms". What distinguishes ADR in the Swiss and the three East Asian cases from the American paradigm, however, is that there is no centrifugal connotation and much less tension with the "shadow of the law" (Haley 1998; Katsuta 1996; Schmiegelow 2006). One might name it as what it is, i.e. relational dispute resolution deserving its own acronym as RDR. Since formal civil procedure in these civil law countries is structurally more efficient than common law civil procedure for reasons discussed in Sect. 5.3.1 and Table 5.3, it is safe to assume

Table 5.4 Out-of-court settlements/alternative dispute resolution (ADR)

Countries / Rules/Structures	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England, Wales	US
1. Prevalence of lawyer-brokered settlements in pre-trial stage	0	0	0	0	0	0	1933	1925
***2.** Arbitration*	(1806) >1870	1879	1890	1960	1969	(1930) 1950	1950	1925
***3**. Mandatory or court supervised conciliation or mediation procedures*	(1790) >1870 - 1940, 1995	2001	>1870 1951	1950	>1870	1950	0	0
***4.** "Justice in many rooms" (Galanter, 1981)*								
***4.a. "** In the shadow of the law"*	0	0	0	0	>1870	0	0	>1870
4.b. *Following local traditions*	0	0	>1870	>1870	>1870	>1870	0	>1870

Legend: The presence of rules or structures is indicated by the year of entry into force of the rules or the establishment of the judicial structures mentioned, preceded by ">" if the entry into force of the rule or the establishment of the structure predates 1870, the starting year of reliable GDP data for dynamic panel analysis; their absence by "0"

Sources: Authors own compilation; Table design: Schmiegelow and Schmiegelow (2012)

that, here, recourse to RDR is not motivated by the economic incentive of using it as a palliative against the cost risk and time loss of inefficient civil procedure, but by a sense of being part of a relationship and a *sui generis* interest in maintaining it. In the US, however, it would be a worthwhile task for American sociology to define and test indicators permitting to measure how often "justice in many rooms" is sought for the *sui generis* relational interest and how often it is used as a palliative against civil procedure risk. American RDR might turn out more attractive in terms of law and economics than even lawyer-brokered out-of-court settlements, which are only by degrees less costly than civil procedure ending in trial.

American RDR is what Djankov et al. (2002) may intuitively have had in mind in their advocacy for the neighborhood paradigm of dispute resolution. But, of course, as a closer look at comparative law and legal sociology literature cited in this and the preceding sections plainly reveals, common law civil procedure can hardly stand for neighborly dispute resolution, as they have assumed. On the contrary, the lawyer-controlled adversarial pre-trial and trial procedures of common law are so far removed from RDR by their cost, slowness and unpredictability that, quite arguably, a centrifugal movement could arise in the 1970s away from the common law to Galanter's "justice in many rooms". Sadly, however, questions have recently been arising about the vitality of the local relational fabric in America. One of the most alarming voices is Robert Putnam's, the political scientist at Harvard who had inspired LOT's early writings about the cultural foundations of common law as a product of Protestant Anglo-Saxon society built on mutual trust as opposed to "Catholic" civil law imposed on citizens by the will of the ruler (La Porta et al. 1999). Speaking of his hometown Port Clinton, Ohio, on the shore of Lake Erie as a "poster child for changes that have engulfed America", he laments the shredding of the social fabric of the 1950s and 1960s by the mid 1990s. "Traditional community bonds failed", he writes, "to prevent the radical shriveling of the sense of "we", as the once thriving middle class gave way to a disparity of "poverty rates of 1 % in gated communities along Lake Erie and 51 % a few hundred yards inward" (Putnam 2013).

5.3.3 Status and Pay of Judges

Were we nonetheless to espouse LOT's neighborly cliché for the common law judge and its characterization of the civil law judge as an instrument of the state, we would obtain another clear-cut common law/civil law divide. However, as referred to in Sect. 3.1, the King's court in England was a state court since the Norman Conquest and, until the 2006 judicial reforms, the Lord Chancellor and the Lord Chancellor's Department have constituted the state authority appointing judges in England and Wales. Of course, prior to the creation of the Supreme Court in 2009, the English court of last resort was the House of Lords and, hence, the mode of selection of its judges a mixture of aristocratic tradition and legislative process.

Montesquieu's separation of powers has certainly been weaker in England than in the US and most European civil law countries (Dam 2006a).

Nor does the case of the US support LOT's association of the common law judge with the neighbor paradigm. Since the entry into force of the American constitution, at least the Federal Courts system of the US with today roughly 900 life-tenured judges appointed by the US President including the nine judges of the Supreme Court (Title 28 of the United States Code (USC), Gur-Arie and Wheeler 2001; Rottman et al. 2000) stands in the way of such an association. Of course, the States of the US are free to design their judiciaries in whatever variation of the principle of separation of powers reflects the preferences of their own State constitutions. Initially, States appointed their judges just like the Union its federal judges. Since 1846, however, the hope that elected judges would be more amenable to grant strict liability in cases pitting industry against public fears led a growing number of States to adopt judicial elections (Shugerman 2010). Until today, there is a lively American debate between proponents of judicial independence, such as afforded by appointments of judges to life tenure, and democratic accountability guaranteed by judicial elections for limited terms. The scholarly debate has been accompanied by more acerbic accusations of party patronage and cronyism against judicial elections, which, since the 1980s, have become increasingly "nasty, noisy and costly" (Shugerman 2010 at 1351), on the one hand, and of an intrinsic economic conservatism of life-tenured federal judges on the other. Many of these accusations have been refuted by examples of unpopular independent rulings of elected judges and path-breaking decisions of life-tenured judges defying conservative inertia. The best characterization of the aggregate state of affairs of the American case is perhaps that the "US is a laboratory of efforts to adjust judicial independence and accountability to one another" (Gur-Arie and Wheeler 2001 at 133). In 1998, general jurisdiction first instance trial judges in 15 States were appointed by the Governor, in 10 States selected through partisan elections, in 18 States through non-partisan elections, and in the remaining States by various methods of selections for various lengths of terms. At the same time, appellate judges were appointed by the governor in 21 States, by legislative appointment in 3 States, by non-partisan elections in 14 States, by partisan elections in 8 States, by retention elections in 4 States (Rottman et al. 2000, Tables 4 and 7). Hence, in no less than 42 % of American State court systems, appellate judges were appointed by the State just as is the rule in civil law countries. If added to the presidential appointment of all life-tenured federal judges, this indicates that the higher the importance of the judicial function to be filled, the safer aggregate America feels with state appointed judges. Again, there is no clear common law/civil law divide.

While acknowledging the venerable Magna Carta tradition of selection or election of judges as "peers" of the seekers of judicial relief as an emblematical achievement of the history of English common law in Line 2, Table 5.5 nonetheless indicates the commonality of the determining role of state-appointed judges in all common law and civil law countries of our sample, except Switzerland, in Line 1. To be sure, Swiss judges are, on principle, elected (Wittek 2006) and there are lay judges in a few of the oldest and smallest cantons of Switzerland or in the

commercial and labor courts of France (Shugerman 2010). But just as the lay judges in Germany's "mixed" commercial and labor courts designated by chambers of commerce and representatives of labor and employers' organizations respectively (Langbein 1985), they do not affect the characteristic prevalence in civil law countries of professional judges in public service nor do they play the same emblematic role as the "peers" in English Magna Carta tradition. Hence, Table 5.5 (line 2) reserves this tradition to the two common law countries of our sample, the salience of the role of appointed judges in public service in England and Wales as well as the US notwithstanding. Arguably, as the Swiss tradition of elected lay judges dates back to 1291, the century of the Magna Carta, it might just as well be inserted in line 2. But while being an expression of an indomitable spirit of liberty and independence surviving until today in the center of Europe, it was not based on a written document defining the rule of law and forced upon a domestic King with autocratic ambitions in the same way as the Magna Carta. So while keeping the Swiss example in mind, we do not need to insert it in line 2 as a qualification of the cultural uniqueness of English common law. Of course, the defining nature of the Magna Carta ideal of judgment by one's peers has long been the jury trial. As explained in Sect. 5.3.2, this feature was abolished for civil cases in England and Wales in 1933, and is in the process of vanishing in the US, yielding to lawyer-brokered out-of-court settlements in both countries. Yet, while disappearing, it remains an English and American cultural treasure and is recognized as such in line 2.

In connection with lines 3–5 concerning the legal education, training and practical experience of judges, it will become immediately clear, however, that line 1 rather than line 2 will be the one that counts for economic analysis of law. For as explained in Sect. 5.3.1 and indicated in Table 5.2 (line 1) and Table 5.3, an active role of the judge as provider of legal knowledge, identifier of legally relevant facts and manager of the pace of procedure is a crucial factor of efficiency of justice. If legally uninformed plaintiffs, such as buyers of subprime mortgage-backed securities (MBS) suing the investment bank selling such MBS for security fraud, were to rely on equally uninformed "peers" to judge the case, the complexities involved would inexorably expect too much of the judge and lull jurors into "dozing off" as reported in the case *SEC vs. Tourré* by the New York Times (2013). However, while neither in England and Wales nor in the US there have been formal requirements of legal knowledge as prerequisites of the appointment or election of judges for the earlier periods relevant for panel analysis (1870–1940s), there has been a growing recognition in common law countries since then that the complexities of the laws and regulations governing modern economies and societies require a thorough legal education for judges (Thomas 2006; UK Ministry of Justice 2005; US Supreme Court 2013). While the UK has mainly relied on in-service training and accumulation of experience as a prerequisite for senior judicial appointments, there was greater emphasis on academic legal education in the US just as in civil law countries. Many of the eighteenth and nineteenth century Justices of the US Supreme Court studied law under a mentor because there were only few law schools in the country, but all Justices appointed since 1942 had a law degree (US Supreme

Court 2013). By 1998, general jurisdiction trial court judges must possess a law degree in all US States but Maine and Massachusetts (Rottman et al. 2000, Table 8).

There has thus been a remarkable conversion of common law countries to standards of legal education and practical experience, which civil law judiciaries have adhered to much earlier (Thomas 2006; Langbein 1985), i.e. simultaneously with the codification of substantive law and civil procedure in the nineteenth century or, in the cases of South Korea and Taiwan, in 1960 and 1950 respectively or, yet, in the case of Switzerland, where practically all elected judges fulfill the pre-entry requirement of academic legal education plus practical training, except in 4 of the smallest cantons preferring lay judges (Langbein 1985; Thomas 2006 Table 2; Canivet 2012; Ebert 1999; Lühring 1997, § 5; Deutsches Richtergesetz 1972; Supreme Court of Japan 2013; Nottage 2010; Kim 2013; Kwon 2011; Gauch 1991; Schneider 1999; du Pasquier 2000; Chen 2012). Table 5.5 (line 3) indicates the commonality of the entry requirement of academic legal education extending to the US at least since the 1940s and line 4 that of the requirement of practical experience as a criterion for promotion, appointment or election to positions of increasing seniority extending to both the UK and the US (Thomas 2006; UK Ministry of Justice 2005; Rottman et al. 2000). Again, then, there is no clear common law/civil law divide.

The only educational entry requirement, where there is such a divide, is the accumulation of academic legal education and practical judicial training in all civil law countries of our sample (Langbein 1985; Thomas 2006, Table 6; Canivet 2012; Ebert 1999; Lühring 1997, § 5; Deutsches Richtergesetz 1972; Nottage 2010; Supreme Court of Japan 2013; Kim 2013; Gauch 1991; Schneider 1999; du Pasquier 2000; Chen 2012), which indicates that civil law judges begin their career at a young age with fresh knowledge of the law and a broad selection of recent cases relevant for legal and judicial practice (Line 5). Hence, seekers of justice at the edge of legal innovation may be luckier at a first instance general jurisdiction court with judges at the beginning of their career in civil law countries than at "trial benches of elderly lawyers" (Frankel 1975 at 1033) in the US. Judging by the criteria of the American debate on judicial independence cited above, the length of the career of civil law judges with multiple possibilities of promotions to senior judicial appointments leaves no more reason to doubt their independence than that of federal judges in the US. That commonality between American federal judges and judges in Western European and East Asian civil law countries should lay to rest LOT's concern about there being "more corruption, less consistency, less honesty, less fairness in judicial decisions" in civil law than in common law countries as quoted from Djankov et al. (2002) at the beginning of this chapter.

The American case invites a few complementary comparative remarks about the two civil law countries of our sample with a federal constitution, Germany and Switzerland. As a rule, German judges begin their careers at a first instance court in one of the *Länder* (States) of the Federal Republic after having taken their second state examination at an appellate court of the *Land*. Their promotion prospects are nonetheless just as federal as the federal codes they apply, interpret, or, if necessary, complement by *richterliche Rechtsfindung* (judge-made law). At the top of the

court system, the Federal Supreme Court of general jurisdiction (*Bundesgerichtshof*), and the four other federal supreme courts of special jurisdiction, i.e. labor relations (*Bundesarbeitsgericht*), social security matters (*Bundessozialgericht*), tax and customs matters (*Bundesfinanzhof*) and litigation between citizens and public administrations *Bundesverwaltungsgericht*) beckon the ambitious. This is a powerful incentive to maintain high ethical as well as legal standards of judicial decision-making (Langbein 1985), the more so as the judgments of State first instance and appellate courts can easily turn into jurisprudence by publication in law journals and commentaries of the federal codes, if their reasoning stands out by innovative departures from established practice of State or Federal courts. It also explains why the "thoroughness of the German judgment is legendary" (Langbein 1985 at 856). This may hardly impress Erhard Blankenburg, the German sociologist of law (Blankenburg 2012). But it is nonetheless plain evidence of a prolific source of judge-made law in a civil law country (Schmiegelow and Schmiegelow 2013) and, therefore, qualifies LOT's assumptions about the common law/civil law divide as one between "adaptive" judge-made law and "political" codified law (Beck et al. 2003; Rajan and Zingales 2003).

Switzerland, at first sight, comes closest to the US case by its federal structure, and closest to England and Wales by the four smallest Cantons (States) continuing to adhere to the principle of lay judges approximating the Magna Carta ideal of judgment by one's peers. However, at a closer look the Swiss case is fundamentally different from both the US and UK cases. Most fundamentally, each of the 26 Cantons has kept its own judiciary since 1291, and Switzerland does not have a three-level Federal Judiciary like the US, only the *Bundesgericht* (Federal Supreme Court) in Lausanne, created in 1848, which is the court of last resort in civil matters (Brunschweiler et al. 2011). Differing from the UK even more strikingly than the US, Swiss judges are elected as a matter of principle, on the first instance level by direct representation ("*Volkswahl*"), on the appellate level either by the cantonal parliament or by *Volkswahl* and on the level of the *Bundesgericht* by the united chambers of the Swiss parliament, the *Bundesversammlung* (Wittek 2006). On the other hand, just as in France and Germany, substantive contract law and commercial law has been the same for judges in the cantons as well as in the *Bundesgericht* to apply and interpret since its codification in the nineteenth century (Boucekkine et al. 2010). If they have been practicing lawyers before being elected as judges, as most of them are as mentioned above, they will do so with very similar techniques of managing the pace of procedure, fact gathering, issue narrowing and judgment writing as their French or German colleagues (Brunschweiler et al. 2011) thanks to the accumulation of academic and practical training at Cantonal appellate courts before entering their legal profession.

Inversely, the evident question that might be raised about the role of American and English judges would be why they should continue to be restrained to what John Langbein calls their "studied amateurism" and passivity in civil procedure, as cited in Sect. 5.3.1. Their education and practical experience would certainly enable them to supply their legal knowledge as a public good just as the civil law judge striving to implement the principle of *iura novit curia*. If appointed to judgeships in

view of previous experience as trial lawyers, they would just have to operate a mental reorientation from the partisan combat mode of the "sporting theory of justice" (Pound 1906 at 417) to attitudes of calm detachment and impartiality considering the trial as being concerned with facts. And they would have to descend "from the peak of Olympian ignorance" (Frankel 1975 at 1042) of the facts in dispute to managing the pace of procedure in order to avoid waste and partisan distortion in the gathering of facts (Langbein 1985). If giants of American law have been advocating such an adjustment of common law civil procedure to modern times for more than a century, from Roscoe Pound's Address to the American Bar Association in 1906, through Judge Marvin Frankel's Benjamin Cardozo Lecture at the Association of the Bar of the City of New York in 1975 to John Langbein's courageous article in the Chicago Law Review of 1985 just cited, it should not be considered as an entirely outlandish idea. The level of efficiency of justice in the UK and the US would dramatically improve and move, as it were, from the three columns on the right of Table 5.3 to the three columns on the left.

At least in the US, some movement in this direction has taken place since the late 1960s in the form of "managerial judging" (Resnik 1982) in complex federal cases such as antitrust, securities, product liability, and class actions. The Manual for Complex Litigation issued by the Federal Judicial Center since 1969 in a regular sequence of new editions recommends among others that judges narrow the issues in a first pretrial conference and limit discovery accordingly (§ 1.30 Manual 1982). Langbein sees this as a sign of convergence with the "conference method" (Kaplan 1960 at 410) of German civil procedure. Other American legal and sociological scholars have voiced misgivings about the criterion of efficiency in connection with justice (Resnik 1982; Galanter and Frozena 2011). Samuel Gross even considers procedural inefficiency as an "American advantage" (1987). If one considers efficiency of justice as a goal, as LOT does, however, one should welcome this bridge over the common law/civil law divide.

Finally, if Djankov et al.'s (2002) concern about avoiding delay and corruption, assuring consistency, honesty and fairness in judicial decisions, and easing access to justice is to be taken seriously, the salaries of judges would merit LOT's attention as well. All judges should be paid well enough to sustain their "role fidelity" (Shugerman 2010) as diligent, incorruptible, consistent, honest and fair providers of justice. Some graduation between salaries of first instance, appellate and supreme court-judges would correspond to the increasing scale of their experience and responsibilities. Inordinate income discrepancies between judges of the all important first instance courts on the one hand and the socially more dignified senior positions at appellate and supreme courts, however, might easily undermine the incentives for first instance judges to maintain high ethical and professional standards.

Empirical research in African, Asian and Latin American countries has shown this to be a particular source of institutional corruption in the judiciary and an impediment for access to justice (Pistor and Wellons 1999; Buscaglia 1997). The problem may be more pronounced in former British colonies of the British empire, where the transplant of the English tradition of combining appellate and supreme

Table 5.5 Status and pay of judges

Countries / Rules/ Structures	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England, Wales	US
1 Appointed or elected Judges in public service	(1806) >1870	1879	1890	1960	(1848) 1870	(1930) 1950	(12th century) >1870	(1787) > 1870
2. Judges and juries selected or elected as "peers" *2.a. judges ruling in bench procedure* *2.b. juries deciding in civil trials*	0	0	0	0	(1291) (>1870)	0	(1215) > 1870 >1870 >1870-1933	> 1870 >1870 >1870
3. Academic training required	>1870	1879	1890	1960	1875 (Basel)	1950	0	1940's
4. Practical experience required	>1870	1879	1890	1960	1875	1950	>1870	>1870
5. Academic plus practical training required	>1870	1879	1890	1960	0	1950	0	0
6. Yearly salary roughly in line with civil service *6.a. first instance level* *6.b. appellate level* *6.c. supreme court level*	 >1870 >1870 >1870	 1879 1879 1879	 1890 1890 1890	 1960 1960 1960	 1875 1875 1875	 1950 1950 1950	 0 0 0	 0 0 0
7. Yearly salary significantly higher than civil service *7.a. appellate level* *7.b. supreme court level*	 0 0	 0 0	 0 0	 0 0	 0 0	 0 0	 >1870 >1870	 >1870 >1870
8 Yearly salary significantly lower than civil service *UK first instance level, US state court levels*	0	0	0	0	0	0	>1870	1938

Legend: The presence of rules or structures is indicated by the year of entry into force of the rules or the establishment of the judicial structures mentioned, preceded by ">" if the entry into force of the rule or the establishment of the structure predates 1870, the starting year of reliable GDP data for dynamic panel analysis; their absence by "0"

Sources: Authors own compilation; table design: Schmiegelow and Schmiegelow (2012)

judicial dignity with aristocratic status, social class and wealth may have met with greater receptiveness in traditional societies such as India's and Malaysia's than the substance of the common law would warrant. Traditional societies in former French colonies may have been less receptive for the comparative egalitarianism of the Napoleonic judiciary, but the French régime was transplanted nonetheless. The problem in francophone developing countries may rather be an egalitarian underfunding of the judiciary as a whole.

Lines 6–8 of Table 5.5 indicate clear common law/civil law divides in judicial salaries. The civil law countries of our sample remunerate their first instance, appellate and supreme court-judges roughly in line with the graduations of their respective civil services (CEPEJ 2008). The UK and the US offer their appellate and supreme court judges significantly higher salaries than comparable members of their own civil service or their continental European colleagues. To cite just one example, with the equivalent of 233,742 € in 2006, UK judges at the supreme court level earned nearly thrice as much as their German colleagues with 86,478 € (CEPEJ 2008). First instance judges in the UK, on the contrary, get significantly lower salaries than their civil service colleagues, particularly so part-time and honorary local court judges (UK Ministry of Justice 2005). A report to the Chief Justice of the State of New York laments a similar lag behind civil service salaries for all State court judges (Rottman et al. 2007). This is not to suggest that first instance judges in the UK and the US are corrupt, perish the thought! But, as a model for developing countries considering reforms of their judiciaries, such marked income discrepancies between first instance and appellate or Supreme Court judges do not recommend themselves in view of the transplant effects reported above in former British colonies.

5.3.4 Status and Pay of Lawyers

Distinctive features of the role of lawyers in civil procedure have already been explained in the preceding three sections in terms of their interaction with judges in the eight countries of our sample. This section serves to complement the data on status and pay of judges by those of lawyers. Again, most of the commonalities in relevant rules and structures cut across the common law/civil law divide and some important differences exist within the common law and civil law subsets of countries. Of the 11 indicators of Table 5.6 only 3 signal a clear common law/civil law divide, of which 2 are, in fact, a divide between the US and the rest of the sample. But all three are of central importance as cost factors affecting access to justice.

The most interesting common law/civil law commonality can be detected, many more or less colorful variations notwithstanding, in the rules and structures shaping the standards of education, practical training and professional experience of the legal profession, most of them shared, sooner or later in their careers, by lawyers and judges. Just like lines 3 and 4 of Table 5.5 concerning the status of judges, lines

3 and 4 of Table 5.6 indicate similar entry requirements for the legal profession, i.e. academic legal education and practical experience (Dubarry 2012; Ebert 1999; Lühig 1997; Supreme Court of Japan 2013; Nottage 2010; Kim 2013; Gauch 1991; Schneider 1999; du Pasquier 2000; Chen 2012; The Bar Council 2013; Solicitors Regulation Authority 2011). The only significant difference arises in line 5 of Table 5.6. While the entry requirement of academic plus practical training for lawyers is common to all civil law countries of the sample, it is not so in the two common law countries.

For lawyers, there is also a divide within the common law subset: In England and Wales, aspirant barristers always had, and still have, to go through practical "pupillage" at experienced barristers' chambers (The Bar Council 2013) and solicitors must enter a training contract with a training establishment (Solicitors Regulation Authority 2011) before being admitted to exercising their profession. In the US, however, a law school degree, usually a J.D., is sufficient as a prerequisite for admission to the bar examination at a state board of examiners, most often at the highest state court in the jurisdiction (American Bar Association 2013). Since most law school students aspiring to become lawyers try to be accepted for "clinics" in one of the big prestigious law firms during summers, the exception has perhaps less practical significance, though, than the difference of UK and US regulations of the profession suggests.

In one respect, there is a significant difference in the practical pre-entry training of lawyers in France, Taiwan, the UK and the US on the one hand and Germany, Japan, South Korea on the other. In the latter, the practical pre-entry training at Germany's appellate State courts, at the Legal Research and Training Institute of the Supreme Court of Japan, the Judicial Research and Training Institute of the Supreme Court of the Republic of Korea is identical for future judges and advocates (Ebert 1999; Lühig 1997; Supreme Court of Japan 2013; Kwon 2011). This means that future judges and lawyers are trained together in the art, described in the two previous sections, of seeing the stories of claimant and defendant side-by-side, separating contested from uncontested, as well as legally relevant from irrelevant, facts, managing the pace of procedure, and writing judgments with reasons of fact and of law. Hence, lawyers in these countries are able to anticipate how the judge will narrow down the issues of a case and advise their client accordingly. Litigants interested in avoiding avoidable cost and time risk of protracted litigation will appreciate such counsel.

In Switzerland, judges are elected without formal pre-entry requirement as mentioned, but most of them are lawyers having gone through a practical training at the Cantonal appellate court comparable to the German case, where they learn the technique of issue narrowing, fact gathering and writing of judgments (Wittek 2006; Gauch 1991; Schneider 1999). Such pre-entry education and training for future judges and lawyers at appellate or supreme courts crucially contributes to efficiency of justice in terms of Table 5.6. In France and Taiwan, the practical pre-entry training of lawyers is separated from that of judges for what appears to be rather different reasons. Marie Goré explains the separation of legal professions in France as a cherished and unique French tradition, whereas Thomas Chen interprets

the Taiwanese case as a recent inclination of Taiwan toward the US system rather than to the Japanese and Korean models (Goré 2012; Chen 2012). In the UK and the US, there is, as explained, no pre-entry requirement of practical training for judges.

While, as indicated in line 1 of Table 5.6, lawyers in both civil and common law countries are educated to consider their profession to be in the service of the law (Dubarry 2012; Busse 2008; Haley 2007; Kawamura 2011; Kim 2013; Kwon 2011; Gauch 1991; Chen 2012; Bar Standards Board 2004; Plant 2011; Children 2007), lawyers in the UK and the US tend to practice it as a business at the same time (Line 2). Danziger and Gillingham (2003 at 193) present anecdotal evidence of the "legal business" that sprang up around Westminster in medieval England. Lord Jackson's report of 2009 finds the combination of passive judges and of two-tiered management of the pace of procedure by expensive solicitors and more expensive barristers in urgent need of reform (Jackson 2009).

In the US, the legal business appears to be a more recent phenomenon. Stephen Harper has carefully researched how leading American law firms have moved away from traditional partnership ideals towards what they "euphemistically" call the "business model" (Harper 2013 at 70) now dominating the private practice of law. A 1975 decision of the US Supreme Court outlawed minimum legal fee schedules for various legal services as a violation of antitrust law. It had a dramatic effect on the predictability of the cost risk of litigation: lawyers turned to hourly billing for actual time spent. "Converting time to money" (Harper 2013 at 71) in an adversarial civil procedure, of which lawyers determine the pace, became part of the business model of private legal practice in the US (Maxeiner et al. 2010). Even an important palliative against this cost risk from the point of view of access to justice, i.e. the contingency fee, was turned by American law firms specializing in class action into a lucrative business lamented by the US Chamber of Commerce (Rickard 2010).

To be sure, as indicated in line 8 of Table 5.6, contingency fees have been admitted in some civil law countries as well, such as in Japan and South Korea since their codification of civil procedure, or in Germany most recently in accordance with a ruling of the *Bundesverfassungsgericht* (Federal Constitutional Court), "if necessary to provide access to justice" (BverfGE 2006, pp. 117, 163–202; Hess and Huebner 2012). Lord Jackson's report (Jackson 2009) recommended it for adoption in the UK. Both the German ruling and the English recommendation are too late to count in the control of long term-panel analysis of DHR for PE. The US, however, stands out by the practice of lawyers charging 40 % or more of the proceeds of the case for the claimant (Rickard 2010), which promises huge profits for law firms specializing in class actions for thousands of clients in one big litigation. Lisa Rickard, the President of the US Chamber of Commerce Institute for Legal Reforms (ILR) reported that the cost of tort litigation amounted to 2.2 % of US GDP in 2005 and warned that "the spread of US style legal compensation" had the potential to break the back of global commerce" (Rickard 2010). Even outside the special interest arguments of the American business community, the debate about the pros and cons of class action under the conditions of American practices of legal compensation goes on (Nocera 2013; American Association for Justice 2013). It appears that contingency fees and class action, both of which should serve as

palliatives against the basic structural inefficiency of common law civil procedure have ended up to constitute a sizable economic problem as a consequence of America's legal profession having turned into a business. Lines 9 and 11 of Table 5.6 indicate the American singularity of this adverse economic effect of exorbitant contingency fees and a share of legal costs in GDP of 2 %, in contrast to all other countries of our sample.

On the other hand, the principle of lawyers' fees negotiated with the client is not, as such, a distinctive feature of the common law side of a common law/civil law divide. France, Japan and Taiwan have it, too (Cayrol 2012; Wagatsuma 2012; Chiu and Sung 2004), as indicated in line 7 of Table 5.6. Inevitably, the principle contributes to "a certain opacity" of litigation costs, as quoted above from Haravon (2010), in these civil law countries as well, although certainly not to one so impenetrable as in the US and the UK. The most predictable, and on average, the least costly regime from the point of view of litigants is the setting of fees by law according to a descending scale of percentages of value of the matter in dispute, which has been the case in Germany, South Korea and Switzerland as indicated in line 6 of Table 5.6 (Hess and Hübner 2012; Lee 2012; Zellweger 2012).

On the whole, it seems fair to say, with Reimann (2012), that problems with high civil litigations costs and, hence, access to justice, result mainly from lawyers' fees and are more severe and pervasive in common law than in civil law jurisdictions. This conclusion does not directly challenge LOT, since LOT, as explained in Sect. 5.2, has not focused on comparative cost, but on comparative formalism and duration of civil procedure. What emerges as a sizable methodological problem, however, is the omission of this factor, especially since Djankov et al. (2002, 2007) rely on lawyers as sources for their data. That lawyers do not volunteer to dwell on their fees in response to questionnaire omitting that question is understandable. But that a theory dealing, like most prominently LOT, with the economic analysis of law does not raise the question of costs, is, to say the least, somewhat disappointing.

High and unpredictable legal cost may not be a decisive impediment for aggregate growth in economies enjoying financial center advantage like those of the UK and the US (Boucekkine et al. 2010), however. As explained already in Sect. 5.3.1, financial investors may turn the cost risk and micro-economic incentive structure of litigation under inefficient common law procedural rules into a procedural advantage against financially weaker parties (Massenot 2010a). For countries like France, Germany, Japan, South Korea and Taiwan, however, whose aggregate growth depends to a much greater extent on industrial sectors in which medium and small enterprises, stylized by Massenot as risk averse engineers (Massenot 2010b), play a crucial role, the opposite incentive structure would be a vital institutional requirement. The comparative cost and time efficiency of civil law procedure in civil law countries provides such an incentive structure.

This is a first confirmation of the procedural efficiency hypothesis of this paper, namely that common law and civil law civil procedure, by their very different degrees of efficiency and their relations of complementary opposition with ADR, transmit substantive common law and civil law rules effectively into an institutional environment sustaining the diverse structural characteristics of each of the eight

Table 5.6 Status and pay of lawyers

Countries / Rules/ Structures	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England, Wales	US
1. Legal profession in the service of the law	(1806) >1870	1879	1890	1960	1875 (Basel)	(1930) 1950	(1215) > 1870	(1840s) > 1870
2. Legal profession as business	0	0	0	0	0	0	> 1870	> 1870
3. Academic training required	>1870	1879	1890	1960	1875	1950	>1870	>1870
4. Practical experience required	>1870	1879	1890	1960	1875	1950	>1870	>1870
5. Academic plus practical training required	>1870	1879	1890	1960	1875	1950	1875	0
6. Fees set by law according to descending scale of percentages of value of matter in dispute	0	1879	0	1960	1875	0	0	0
7. Fees per hour negotiated with client	>1870	0	1890	0	0	1950	>1870	1975
8. Contingent fees admitted	0	2008	1890	1960	0	0	0>	1870
9. Average contingent fee 40% or more of proceeds from case	0	0	0	0	0	0	0	1975
10. Average contingent fee below 40% of proceeds	0	2008	1890	1960	0	1950	0	0
11. Share of legal profession in GDP 2% or more	0	0	0	0	0	0	0	2005

Legend: The presence of rules or structures is indicated by the year of entry into force of the rules or the establishment of the judicial structures mentioned, preceded by ">" if the entry into force of the rule or the establishment of the structure predates 1870, the starting year of reliable GDP data for dynamic panel analysis; their absence by "0"

Sources: Authors own compilation; table design: Schmiegelow and Schmiegelow (2012)

economies of our sample. Boucekkine et al. (2010) argued that the superior number of codified default rules for the ten economically most important contract types was an effective institutional environment for industrialized civil law countries without financial center advantage leading to a long term evolution of their GDP per capita converging with, and at times superior to, common law countries with financial center advantage. Indeed, after having surveyed the first 4 of our 8 categories of indicators, there are prospects that the PEH of this chapter might sustain the DRH of the Boucekkine et al. (2010 and Chap. 3 of this book).

Switzerland, of course, has it both ways, combining financial center advantage and a dynamic industrial sector with a balanced mix of small, medium and big enterprises (Boucekkine et al. 2010, Chap. 3). Zellweger's (2012) characterization of the costs of Swiss civil procedure as "pricey but predictable" appears to fit the composite structure of the country's economy with uncanny accuracy. Indeed, in Massenot's terms, the "priceyness" should please financial market litigants used to let risks work in their favor, whereas the "predictability" should encourage risk-averse engineers to go, if necessary, to court for contract enforcement or other judicial relief, if their cases are evidently meritorious. With this particular composition, Swiss civil procedure appears to serve both the major sectors of the country's economy as a functional institutional framework.

5.3.5 Cost Rules and Structures

PEH is further confirmed by a comparison of rules on cost and fee allocation between the litigants as well as structures of court costs and levels of lawyers' fees. This is not obvious at first sight. None of the seven lines of indicators in Table 5.7 presents a clear common law/civil law divide. But if seen in light of the counterintuitive efficiency divide explained in Sect. 5.3.1 and schematized in Table 5.3, the most striking features of the incentive structures of the cost regimes of the eight countries become immediately apparent. As indicated in lines 1 and 2, all 8 countries shift the burden of court costs of the winning side to the loosing side, while only Germany, South Korea, Switzerland and the UK do so also for the lawyers' fees of the winner. France, Japan, Taiwan (except in appeals to the Supreme court) and the US follow the principle that each party pays its own lawyer's fees (Cayrol 2012; Hess and Huebner 2012; Wagatsuma 2012; Lee 2010; Zellweger 2012; Chiu and Sung 2004; Moorhead 2012; Maxeiner 2012).

In the US, this is called the "American rule", while the allocation of lawyer's fees of the winning party to the loser is called the "English rule" (Maxeiner 2012). In principle, this is a fundamental difference between the two leading common law countries in terms of access to justice. The shifting of the winning party's lawyer's fees to the looser is considered, as a rule, to ease access to justice for poor or middle class claimants with meritorious cases. This incentive in favor of financially weaker claimants is confirmed by high litigation rates in German speaking civil law countries (Reimann 2012) as well as in South Korea (Lee 2010). But, as discussed

in the preceding sections, these are also countries with efficient civil procedures managed by judges. Hence the downside risk of having to bear both sides' lawyers' costs rather than none in case of an unexpected dismissal of the claim is much smaller, and moreover, more predictable, than in American or English civil procedure.

The same cannot be said about the English cost-shifting rule. On the contrary, given the much more sizeable cost risk of accumulated solicitors and barristers fees in the case of dismissal after a more lengthy procedure controlled by lawyers rather than the ideal-typically passive common law judge, potential claimants will think twice before going to court. The original intent of the English rule may well have been to discourage "frivolous suits" rather than easing access to justice. To wit, Lord Jackson, in his 2009 report on the review of civil litigation costs in the UK, proposed to introduce contingency fees as well as a more active role of judges for the purpose of easing access to justice (Jackson 2009). Until such reforms are implemented however, the commonality of the incentive structure of inefficient lawyer-dominated civil procedure in the UK and the US continues to favor the financial markets which have crucially contributed to the aggregate growth of their economies in the period from 1870 to 2008.

Line 3 of Table 5.7 indicates the contrast between lawyers' fees set by law in descending scales of value of the matter in dispute on the one hand and fees freely negotiated with clients on the other. For the former, the German example is straightforward and well documented by Hess and Huebner (2012), while Koreans routinely negotiate supplements to the scheduled fees, which are difficult to document (Lee 2010). The problem is even greater in the case of countries privileging freely negotiated fees. Given the difficulty of predicting the time lawyers need to spend for their clients, data for France, Japan, Taiwan, the UK and the US are almost impossible to obtain. Fortunately, however, Maxeiner (2010) has constructed an ideal-typical case, "Roe vs. Doe", detailing how the American rule easily leads to a sum of lawyers' fees for the winner Roe alone in excess of his $75,000 claim awarded him by the court, i.e. $77,500 or 103 %. This compares with a total cost in scheduled fees for both sides of only 10,664 € ($14,220), or 10,7 % of an amount in controversy of 100,000 € ($133,350), to be paid by the looser in the straightforward case of Germany (Hess and Huebner 2012). In Maxeiner's words (Maxeiner et al. 2010 at 32), "without control of costs, and in the absence of a loser pays system, defense counsel, through a vigorous defense, can render a $75,000 claim valueless" in the US. This example illustrates how major American mortgage lenders could turn the comparative inefficiency of American civil procedure into an advantage against financially weak mortgage borrowers in order to avoid mortgage modification in the subprime crisis of 2007, while two major industrial enterprises fought it out on a long term delivery contract in *Alcoa vs. Essex Group* in the oil crisis of the 1970s on the basis of the common law default rule of frustration of purpose (Schmiegelow and Schmiegelow 2013, Chap. 4). Alcoa and Essex Group were perhaps among the last few American enterprises to take the risk of a trial, before the obsession with billable hours took hold of the legal profession as a result of the 1975 Supreme Court decision discussed in the previous section.

In 1923, Austin W. Scott of Harvard Law School, took issue with LOT by anticipation, as it were, when he wrote in a seminal article in the Harvard Law Review reprinted in the ABA Journal of the same year: "The common law system of civil procedure, in its essential principles so sound, has been applied, however, with such technicality, as frequently to defeat its own purpose. (. . .) There are two classes of controversies in particular in which our ordinary legal procedure has broken down to such an extent that it may fairly be said that the result has frequently been a denial of justice: First, those cases in which the amount in controversy is small; and second, those in which one of the parties is so poor that he cannot afford to wage a legal battle" (Scott 1923 at 457). Lines 4–7 of Table 5.7 deal with solutions, or for want of solutions with palliatives, to the problems of these two classes of controversy in the eight countries of our sample.

Self-representation is the obvious solution for both small claims and poor parties (Line 4 of Table 5.7). All civil law countries of our sample have allowed self-representation in first instance courts for amounts of small claims level since the codification of their civil procedure. For Germany, Hess and Huebner (2012) document total court cost of 165 € for both parties, i.e. 16 % for a value of the matter of 1,000 €, which the looser must pay. In England and Wales, a special small claims track was created in county courts in 1973 (UK Ministry of Justice 1973), where the cost risk for the looser for an amount in controversy equivalent of 1,000 € today is a similar 16 % (UK Government 2013). In the US, Austin Scotts' 1923 article was the trigger of a movement for the establishment of special small claims courts first in bigger cities and then in all states. Here the "American Rule" of each party pays its own cost turns out as a small advantage. The cost of a claim in the equivalent of 1,000 € in California is just 2 % for each party (California Department of Consumers 2010).

Unlike the US, the three civil law countries sharing both the "American" rule and the principle of negotiated lawyer's fees, France, Japan and Taiwan, offer an important palliative for financially weaker parties against the incalculable cost risk resulting from that combination. The CPC, the Minjishosho-ho and the TCCP give the judge discretion to award the winning party reimbursement of its costs by the losing party as damages (Line 5). Japan has permitted the palliative of class actions in 1969, but so far without the unintended consequence of triggering a new business model for law firms as discussed in the previous section in the case of the US (Line 6). France, Germany, Japan, South Korea and Taiwan provide legal aid for civil procedure since its codification (Cayrol 2012; Hess and Huebner 2012; Nakajima 2012; Lee 2010; Chiu and Sung 2004). The UK followed suit by the Legal Aid and Advice Act 1949, which was part of the emergence of the welfare state in the UK and attempted to compensate the high cost level of common law procedure (Goriely 1999). Switzerland and the US are the only countries of our sample, which have not committed themselves to public legal aid until today. In Switzerland, the allocation of court costs and lawyers' fees to the loosing side functions as a procedural rule keeping access to justice nonetheless open for poor claimants with meritorious cases. In the US, the absence of public legal aid in civil cases, combined with the "American rule" of each party having to pay its own lawyers fees, has been, and still

Table 5.7 Cost rules and structures

Countries / Rules/ Structures	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England, Wales	US
1. *Loosing party pays*								
1.a. *all court costs*	(1806) >1870	1879	1890	1960	1875 (Basel)	(1930) 1950	(1215) > 1870	(1840s) > 1870
1.b. *all court costs and winning party's lawyer's costs*	0	1879	0	1960	1875	0	>1870	0
2. *Each party pays its own lawyer's costs*	>1870	0	1890	0	0	1950	0	1870
3. *Total cost for both sides of one claim in absolute numbers (court costs plus lawyers' fees)*								
3.a. *set by law according to descending scale of value of matter in dispute*	0	1879	0	1960	1875	0	0	0
(in € or equivalent of € in other currencies:								
3.a.a. *claim of 1,000 €*		709 € (70,0%)						
3.a.b. *claim of 10,000 €*		3,519 € (35,2%)						
3.a.c. *claim of 100,000 €*		10,664 €(10,7%)						
3.a.d. *claim of 1,000,000 €)*		40,159 € (4,0%)						
3.b. *estimated average allowing for wide margins of hourly lawyers' fees*	n.a.	0	n.a.	n.a.	0	n.a.	n.a.	n.a.
3.b.a. *claim of 1,000 €*								77,500 € (103% of 75,000 in controversy)
3.b.b. *claim of 10,000 €*								
3.b.c. *claim of 100,000 €*								
3.b.d. *claim of 1,000,000 €*								
4. In countries allowing self representation for small claims, total cost, if neither party involves lawyers: claim of 1,000 €	>1870	1879 165 € (16,5%)	1890	1960	1875	1950	1973 164 £ (16%)	1923 30 $ (2 %)
5. Judge may award winning party reimbursement of its costs as damage	>1870	0	1890	1960	0	1950	0	0
6. Class action admitted	0	0	1969	0	0	0	0	1938
7. Public legal aid (Counsel or Cost assistance) for indigent parties available	>1870	1879	1890	1960	0	1950	1949	0

Legend: The presence of rules or structures is indicated by the year of entry into force of the rules or the establishment of the judicial structures mentioned, preceded by ">" if the entry into force of the rule or the establishment of the structure predates 1870, the starting year of reliable GDP data for dynamic panel analysis; their absence by "0"

Sources: Authors own compilation; table design: Schmiegelow and Schmiegelow (2012)

is, a structural problem of access to justice, except for small claims. It was left to civic initiative to establish the Legal Services Corporation (LSC) in 1974 (Kilwein 1999).

In the 1980s and 1990s, however, both public legal aid in the UK, once disposing of the largest budget in the world for that purpose, and the LCS in the US went into decline (Regan et al. 1999). This happened to occur simultaneously with the rise of the share of the financial sectors in the UK and the US economies. According to Massenot's (2010a) micro-economic hypothesis, the decline of legal aid must have reinforced the inverse incentive structure of common law procedure as a deterrent of litigation against financial actors. The financial sector advantage of the two common law countries compensated the default rule advantage of the six civil law countries (Boucekkine et al. 2010). Control for PE further confirms DRH.

5.3.6 Density of Judicial Structures

For access to justice narrowly defined as access to the judiciary, the number of courts, judges and lawyers per 100,000 inhabitants is the most important structural indicator. Lines 1–3 of Table 5.8 indicate the numbers, both absolute and relative per 100,000 inhabitants, of first instance courts, appellate courts and supreme courts as courts of last resort respectively. Data of absolute numbers of these courts in France, Germany, and the UK are documented by Youngs (2007) and CEPEJ (2008), for Japan by Tanaka and Smith (2000), for South Korea by the Korea Court Organization Act (1949), for Switzerland by CEPEJ (2008), for Taiwan by Taipei District Court (2013), Taiwan High Court (2013), Judicial Statistics of the ROC (2012) and Judicial Yuan (2013), and for the US by National Center of State Courts, 2013 and US Courts (2013). Lines 1 and 2 indicate that the density of first instance and appellate courts is highest in Switzerland, Germany, and France followed by Japan, the US, the UK, South Korea and Taiwan for first instance courts, and by the US, Taiwan, Japan, South Korea for appellate courts with England and Wales coming last. All countries have, of course, supreme courts of last resort in civil matters. In six countries, these courts are, at the same time, constitutional courts, whereas Germany and South Korea have separate constitutional courts offering a "fourth instance", as it were, on questions of constitutionality of the civil law norms applied in the previous three instances.

Overall, Switzerland, the mother countries of LOT's French and German LO and Japan score in terms of access to justice as measured by the density of their court systems, especially the nearness of the first instance courts. If it were not already for the businesslike "conference method" of civil law procedure as opposed to the high drama of the concentrated common law trial explained in Sect. 5.3.1, this local nearness brings them, in fact, much closer to the neighborly function of courts, stylized by Shapiro (1981), than American and English courts actually are. The UK stands out by its highly centralized appellate court system with the High Court and the House of Lords in London (Youngs 2007), the US by its relatively modest score

of density in spite of the duplication of three-tiered court systems on both State and Federal levels. Hence, on the point of accessibility of courts by neighborly nearness, too, Djankov et al. (2002) are challenged in one of their basic assumptions cited in the beginning of this chapter. And, of course, superior access to justice by density of the court system is one more confirmation of PEH in the civil law countries mentioned.

So is access to justice as measured by the number of judges per 100,000 inhabitants. The data for line 4 were supplied by CEPEJ (2008) for all European countries, for Japan by Prof. Hiroshi Matsuo of Keio University to the author in 2011, for South Korea and Taiwan by Pistor and Wellons (1999) and for the US (judges in general jurisdictions courts and single-tiered courts separately) by LaFountain et al. (2012). Here, Germany stands out with what is considered the worldwide highest number of judges (Blankenburg 2012), followed by Switzerland and France in the next two top spots before the US, England and Wales, Taiwan, South Korea and Japan.

Predictably, considering the dominant role of lawyers in common law procedure explained in Sect. 5.3.1, the "tables are turned" when it comes to lawyers as part of judicial structures (Line 5). The two common law countries leave the six civil law countries of our sample far behind, with 387 lawyers per 100,000 inhabitants in the US, and 243 solicitors plus 22 barristers in England and Wales, as against 168 in Germany and a decreasing scale of density in the other five civil law countries (American Bar Association 2011; CEPEJ 2008, Prof. Matsuo to the author in 2011 concerning Japan, Schwartzmann 2008 concerning South Korea, Winkler Partners 2012 concerning Taiwan). With these numbers, the UK and the US might have scored in terms of access to justice. But, the dominant role of lawyers in common law procedure and the high cost risk for litigants resulting from that role, as explained in Table 5.3 and Sect. 5.3.7, tends to impede rather than ease access to justice. At best, the numbers illustrate Massenot's (2010a) inverse incentive structure of inefficient common law procedure, which might have helped sustain the financial center advantage of the US and the UK. Indeed, if one accepts the arguments of the financial industry in favor of deregulation and the phenomenon, described by Soros (2008), that financial regulation is always "behind the curve of financial innovation", it does not take a large step to follow Massenot's thesis that the cost inefficiency of the role of lawyers in common law procedure is an advantage for the financial industry.

While, as argued in Chap. 4, substantive common law will never be behind the curve of financial innovation thanks to its timelessness, the inefficiency of its lawyer-dominated common law procedure may well fail to transmit it into practice. The ruling on contract modification in *Aluminum Co. of America* (*ALCOA*) *v. Essex Group* (1980) cited in the preceding section may serve as a case in point. Applying the common law default rule on "frustration of purpose" to a long-term industrial contract concluded in 1967 running until 1983 which assumed normal inflation and could not foresee the extraordinary rise in electricity prices triggered by the 1973 oil crisis, it certainly broke an innovative path of judge-made law. DRH, controlled for PE, was confirmed for the American economy in this one outstanding industrial

Table 5.8 Density of judicial structures per 100,000 inhabitants

	Countries							
Rules/structures	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England Wales	US
1. Civil law 1st instance Courts	(640[a])	(902[b])	(867[c])	(161)	(302[d])	(66)	(220[e])	(1,836[f])
	1.0	1.1	0.68	0.3	3.95	0,28	0.40	0.58
2. Civil law appellate courts	(30[g])	(144[h])	(15[i])	(6)	(26[j])	(6)	(1[k])	(163[l])
	0.04	0,17	0.014	0.012	0.43	0,02	0.001	0.05
3. Civil law Supreme courts and/or constitutional courts controlling the constitutionality of civil law norms	(1[m])	(2[n])	(1[o])	(2[p])	(1[q])	(1)	(1[r])	(1)
4. Judges[s]	(7,532)	(20,138)	(3,026)	(1,212[t])	(1209)	(1,252)	(3,774)	(7,590)
4.a Number of non-professional judges per professional judge	11.9	24.5	2.3	2,42	16.5	5,3	6.9	(3,439)
	0.4	4.9					7.6	6,8[u] 2.8[v]
5. Lawyers (in UK England, Wales: barristers)[w]	(47,765)	(138,104)	(30,447)	(10,000[x])	(7,530)	(7000[y])	(12,034)	(1,225,452[z])
5.a. Solicitors in UK England, Wales	76	168	23,7	20	101	30	22,2	387,7
							(131,347)	
							243	

[a]460 Tribunaux d'instance, 180 Tribunaux de grande instance, Youngs (2007)
[b]782 Amtsgerichte, 120 Landgerichte in 2006 Youngs (2007), CEPEJ (2008)
[c]575 Summary Courts, 292 District Courts, Tanaka and Smith (2000)
[d]Zivilgerichte in 2006, CEPEJ (2008)
[e]County Courts, Youngs (2007, p. 89)
[f]National Center of State Courts (2013)
[g]Cours d'appel, Youngs (2007, p. 92)
[h]120 Landgerichte hearing appeals from Amtsgerichte, 24 Oberlandsgerichte hearing appeals in 1st instance cases from Youngs (2007, p. 93)
[i]15 appellate courts, including 6 branch offices and 1 for intellectual property cases, data kindly contributed by Prof. Hiroshi Matsuo (December 2011)
[j]Obergerichte of the 26 Swiss Cantons
[k]Court of Appeal in London, Youngs (2007, p. 92)
[l]13 Federal Appeal Courts, 101 State Courts of Appeal, 49 State Supreme Courts with appellate divisions
[m]Cour de Cassation in Paris
[n]Reichsgericht in Leipzig 1879–1945, since 1949 Bundesgerichtshof for civil cases and Bundesverfassungsgericht for constitutionality control in Karlsruhe

[o]Supreme Court in Tokyo
[p]Supreme court of general jurisdiction and constitutional court
[q]Bundesgericht in Lausanne
[r]House of Lords until 2009, since then Supreme Court
[s]All numbers from CEPEJ (2008), except data for Japan, contributed by Prof Matsuo
[t]In 1999, Pistor and Wellons (1999, p. 234)
[u]Judges in general jurisdiction courts in 46 states LaFountain et al. (2012)
[v]Single-tiered courts in six states LaFountain et al. (2012)
[w]All numbers from CEPEJ (2008), except data for Japan, contributed by Prof Matsuo, South Korea (note 24) and Taiwan (note 26)
[x]Schwartzmann (2008)
[y]Winkler Partners (2012)
[z]American Bar Association (2011)
Source: Authors own compilation; Table design: Schmiegelow and Schmiegelow (2012)

case. In the subprime crisis three decades later, the American financial industry appeared to prefer this ruling to remain "law on the books" without its logic being applied by efficient civil procedure to mortgage modification in the subprime crisis. This crisis was one of extraordinary deflation. It frustrated the purpose of millions of mortgage contracts sold by leading financial institutions on the premise of continuously rising house prices. This premise was based on the seeming mathematical persuasiveness of the Gaussian copula function used by the community of Wall Street "quants" (Schmiegelow and Schmiegelow 2013, Chap. 4). In this case DRH was not confirmed until today for the US economy, if controlled for PE, except for US financial institutions, which were able to avoid litigation from millions of subprime mortgage borrowers facing foreclosures while being bailed out effectively by the US government and supported in their recovery by the Federal reserve through successive programs of quantitative easing.

5.3.7 Litigation Density

Litigation density is the subject of ongoing discussions among sociologists of law, about whether high litigation rates are indicators of social dysfunction (Blankenburg 1988; Rickard 2010) or of increasing economic development (Crossman and Sarat 1975; Wollschläger 1998) or of institutional variation within countries (Clark 1990). I submit that the least one may say is, that statistically significant litigation rates, on national or subnational levels, are an unmistakable control of any hypothesis on access to the judiciary or comparative efficiency of civil procedure, i.e. PEH in this chapter.

Data on civil law cases per 100,000 inhabitants in line 1 of Table 5.9 are obtained for the mid 1990s from Wollschläger (1998), except for Japan (Prof. Matsuo to author for data of 2010), South Korea (Lee 2010 for data of 2005), Switzerland (CEPEJ 2012 for data of 2010), and the US (LaFountain et al. 2012 for data of 2010). In spite of the variation of sources and years of the data, significant structural differences emerge from the ranking of litigation densities as follows: Germany, South Korea, UK, US, France, Switzerland, Japan, Taiwan.

The two top rankings confirm PEH in civil law countries with the following efficiency advantages: active judges in public service applying their legal knowledge as a public service, narrowing issues, managing the pace of procedure, and writing judgments containing reasons of fact and of law (Sects. 5.3.1 and 5.3.3), absence of demand for ADR as a palliative against judicial inefficiencies (Sect. 5.3.2), lawyers sharing academic and practical training with judges and considering their profession as being in the service of the law rather than as a business (Sect. 5.3.4), and, finally, cost rules making court costs and lawyers fees comparatively predictable and modest as well as shifting them to the losing party (Sect. 5.3.5). In addition, Germany relies on the highest densities of courts and judges per 100,000 inhabitants to ease access to justice (Sect. 5.3.6).

That the following two ranks go to the two common law countries of our sample may surprise at first sight in view of the inefficiency of lawyer-dominated (Sect. 5.3.1 and Table 5.3) and, hence, high cost (Sects. 5.3.4 and 5.3.5) of common law procedure. However, since demand for law in the UK and the US can be assumed to be just as inelastic as in other developed civil law countries, the palliatives for claimants against procedural inefficiency in both countries must be reflected in higher litigation rates than an elastic reaction to the inverse incentive of procedural inefficiency would generate in the absence of such palliatives. Most important for the UK is the rule shifting costs to the losing party, which eases access to justice in the same way as in German speaking countries and Korea. The fast track for small claims has been the next most important palliative since 1973 (Sect. 5.3.5) and must have contributed a share of filed cases comparable to the summary debt procedure in Germany, which was 67 % in Wollschläger's 1995 data (Line 1.b). Legal aid may still have financed some share of litigation for poor claimants in the postwar period up to the 1970s before the decline of this palliative began in the 1980s (Sect. 5.3.5). Both the UK and the US share the rise of lawyer-brokered out-of-court settlements as a palliative for financially weaker parties against the cost risk of continued controversy through protracted pre-trial discovery procedures up to the unpredictable drama of what Benjamin Kaplan (1971) has called the "single-episode trial" (Sect. 5.3.2). The abolition of the civil trial in England and Wales in 1933 (UK Administration of Justice (Miscellaneous Provisions) Act 1933) and the vanishing of the trial in the US discussed in Sect. 5.3.2 indicate the strength of the incentive to settle out of court after filing the case. However, American claimants are in a weaker position than English ones, because the "American rule" (Sect. 5.3.5) prevents them from using cost shifting to the loser as a bargaining chip. Contingency fees (Sect. 5.3.5), and class actions (Sect. 5.3.6) have been compensating palliatives for American seekers of access to justice unable to take alone the entire cost and time risk of lawyer-dominated common law procedure.

That France, Japan and Taiwan share the "American" cost rule (Sect. 5.3.5) explains a good deal of their trailing places in litigation density and the more prominent role of ADR in these three civil law countries, with Japan enjoying the particular benefit of a cultural tradition of relational dispute resolution (RDR) as explained Sect. 5.3.2. As reported by Nakajima (2012, Chap. 12), however, a recent legal aid reform has resulted in a significant increase of the litigation rate, which speaks in favor of an institutional explanation of changes in litigation density. That Switzerland trails France in spite of sharing Germany's and Korea's cost shifting to the looser and scheduled lawyers' fees, is well explained by the important share of the financial sector in the Swiss economy and Massenot's (2010a) disinclination of financial market agents for efficient judge-managed civil procedure. Some of Massenot's (2010b) stylized engineers who, on the contrary, appreciate efficient civil procedure might yet be deterred by the "priceyness" of Swiss scheduled court costs and lawyers' fees (Sect. 5.3.5).

Cross-country differences in appeal rates (Line 2 of Table 5.9) may be explained by restrictions imposed by law. Appeals may be restricted to cases above a certain

Table 5.9 Litigation density (number of civil law cases per 100,000 inhabitants)

	Countries							
Rules/ structures	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England Wales	US
1. Civil law cases	4,040	12,320	1,701	7,806	2,172	1,690	6,440	5,317
1.a. of which Contract law cases	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3,243 (61 %)
1.b. of which summary debt procedures	1,100	8,340 67 %	520	n.a.	n.a.	960		
2. Appeals (in percent of first instance judgments)	12 %	1 %	16.8 %	3.5 %	6 %	9.4 %	7 %	
3. Cassation/ Revision (in percent of appeal court judgments)	n.a.	n.a.	24.9 %	n.a.	n.a.	3.3 %	n.a.	n.a.

Sources: Authors own compilation; table design: Schmiegelow and Schmiegelow (2012)

monetary value of the claim or subject to admission from either the lower court or the court of appeal. Monetary restrictions prevail in countries of French and German LO. Their impact is statistically not significant (OECD 2013). In spite of such "astonishingly liberal" (Langbein 1985 at 857) accessibility of second instance courts, which raises access to justice to a further level, Germany's appeal rate reported by the OECD is surprising low with 2 %. The OECD associates low appeal rates with high predictability of appellate court decisions. I would rather submit that the low German rate is a result of the "legendary" (Langbein 1985 at 856) care, which German career first instance judges invest in the reasoning of fact and of law of their written judgments in order to reduce the risk of appellate reversal, as discussed in Sect. 5.3.3. French and Japanese judgments tend to be much more succinct by cherished traditions of judicial style, which may explain the rates of appeal of 12 % in France and 16.8 % (Prof. Matsuo to author 2011) in Japan. Restrictions by the requirement of leave to appeal prevailing in countries of English LO reduce appeal rates significantly, to 7 % in the case of England and Wales (OECD 2013). As the figures for South Korea, Switzerland and Taiwan are below 10 % as well, there is definitely no common-law/civil law divide in appeal rates. This commonality loses most of its apparent significance, however, if one considers the paucity of procedures ending in a judgment in England and Wales (just 2 % of

filed cases as reported by CEPEJ 2008) and the vanishing of the trial in the US as discussed in Sect. 5.3.2.

To conclude this section, it is fair to say that litigation density reflects both higher PE in civil law countries and the effect of palliatives against low PE of common law procedure as explained in Sects. 5.3.1–5.3.6. PEH, controlled for litigation density, is confirmed.

5.3.8 Duration of Civil Proceedings

Higher PE for civil law procedures is also indicated by the category duration of civil procedure. This is particularly striking as duration is the single procedural factor of control used by LOT to support its thesis that "formalism is systematically greater in civil law countries than in common law countries and is associated with", among other social dysfunctions, "inferior access to justice" (Djankov et al. 2002). Unfortunately, the available CEPEJ data on clearance rates of incoming first instance civil law cases per year do not go back further than 2004 (CEPEJ 2006), and those of the National Center for State Courts, not further than 2010 (LaFountain et al. 2012). Building a long time series as in Boucekkine et al. (2010) is impossible. Therefore, for the purpose of controlling LOT's broad-brush assertion of "higher expected duration of judicial proceedings in civil law countries" (Djankov et al. 2002), I propose to be content with the binary checks of clearance rates above 100 % by year-end in line 1 of Table 5.10. Only Germany got through the 100 % goal in 2006 and the following years (CEPEJ 2008, 2012). The notes to line 1 indicate rates between 96 and 99 % for France, Switzerland, the UK and the US with references.

The binary check for disposition times for first instance civil cases below 200 days in line 2 is based on the same data on duration of civil procedure as Table 5.1, i.e. those collected by Djankov et al. (2007) for enforcement of contractual debt worth 50 % of GDP pc in 129 countries. As explained in Sect. 5.2, this is a case type more relevant economically than the case types "eviction of tenants" and "collection of bounced checks" used by Djankov et al. (2002). It is also more relevant for the control of DRH in Boucekkine et al. (2010) for PE in this chapter.

In all civil law countries of our sample, except Taiwan, disposition time is below 200 days. In the UK and the US it takes longer, as indicated in Table 5.1. Why our sample of countries, which includes the mother countries of English, French and German LO, three financial centers (London, New York and Zurich) and two newly industrialized countries (South Korea and Taiwan) offers a more accurate measure of the intrinsic qualities of civil law and common law than Djankov et al.'s (2007) sample of 129 countries, is explained in Sect. 5.2.

Hence, PEH is also confirmed if controlled for duration of judicial proceedings. Contrary to LOT's assumptions, PE is higher in industrialized civil law countries than in common law countries.

Table 5.10 Duration of civil law proceedings

	Countries							
Rules/structures	France	Germany	Japan	South Korea	Switzerland	Taiwan	UK, England, Wales	US
1. Clearance rate[a] of incoming 1st instance civil cases above 100 %	0[b]	1[c]	n.a.	n.a.	0[d]	n.a.	0[e]	0[f]
2. Disposition time for 1st instance civil cases below 200 days[g]	1	1	1	1	1	0	0	0

Notes: Clearance rate and disposition time as defined by the European Commission for the Efficiency of Justice of the Council of Europe (2008)

[a]Percentage of cases pending on January 1, which are cleared by December 31: clearance rate (%) = resolved cases/incoming cases × 100

[b]96 % in 2006, CEPEJ (2008 at 135)

[c]143 % in 2006, CEPEJ (2008 at 135)

[d]99.5 % (in 2010), CEPEJ (2012 at 193)

[e]2 % in 2006, CEPEJ (2008 , p. 136) explains: "It should be noted that the clearance rate for UK–England and Wales is low. Due to their legal system (common law) many cases do not end in a judgment"

[f]99 % in single tiered state courts (including traffic courts), 98 % in general jurisdiction state courts (without traffic courts), LaFountain et al. (2012)

[g]Based on data collected by Djankov et al. (2007) for the enforcement of a contract of unpaid debt worth 50 % of GDP per capita in 129 countries, for data on average number of days, see Table 5.1

Source: Authors own compilation; table design: Schmiegelow and Schmiegelow (2012)

5.4 Conclusion

The eight categories of the Louvain Questionnaire on rules and structures of civil procedure identify more significant and reliable cost and time factors affecting access to justice in common law and civil law countries than LOT's single category of formalism. The most critical divide between the two legal traditions is the very different balance between the roles of judges and lawyers in providing knowledge of the relevant laws, narrowing issues of facts and managing the pace of procedure. The most authoritative American and English sources of comparative law and of reforms of civil procedure in the UK acknowledge or imply that judge-managed proceedings in civil law countries are more efficient than traditional lawyer-dominated proceedings in common law countries. Out-of-court settlements and ADR are important palliatives against common law procedural inefficiencies. This comes at the cost, however, of the "vanishing of the civil trial" both in the UK and the US. Hence, civil law procedure has been producing more judge-made law since the beginning of the twentieth century than common law procedure, serving an "adaptive" legal process rather than assuming the "political" functions attributed to it by LOT.

The categories status and pay of judges and lawyers, cost and fee allocation, as well as density of judicial structures confirm the efficiency divide from the point of view of the users of the judicial systems. These results are controlled for litigation rates, clearance rates and LOT's own single variable of control, namely duration of proceedings to enforce contractual debt worth 50 % of GDP pc, using LOT's own data. One obvious problem with LOT's 2002 and 2007 ventures into the subject of civil procedure was their reliance on the single factor of formalism and the single control variable of duration just mentioned, both of which masked the decisive factor of cost as one of the most important thresholds for access to justice. Another problem is the price LOT had to pay for the robustness of its cross-country analyses with samples of between 106 and 129 countries. With these samples, overwhelmingly composed of former colonies, more than 50 % of them coded as of French LO, LOT's authors unwittingly measured the negative transplant effect of imperial imposition of the laws of colonial powers to unreceptive countries rather than the intrinsic efficiency of common law or civil law judicial procedures. In order to identify the rules and institutional structures determining the comparative efficiency of common law and civil law procedures, it is necessary, to isolate them as much as possible from distorting effects, such as reverse causation by wealth, the relative importance of financial and industrial sectors, or, most importantly for cross country analysis with large country samples, the transplant effect in former colonies. Although LOT recognizes the first of these three distortions, it remains oblivious of the second and the third.

The sample of eight countries used in this chapter makes it easier to avoid all three distortions. With the mother countries of English, French and German LO, it includes one which was wealthy at the time of the major civil law codifications in the nineteenth century (UK) and two which were relatively backward industrially and financially (France, Germany). The sample also includes three countries with financial center advantage, two of English LO (UK, US) and one of German LO (Switzerland), which permits consideration of micro-economic analyses of diverse incentives resulting from procedural efficiency for financial and industrial litigants. The sample also comprises two former colonies (South Korea, Taiwan), which having developed their own substantive and procedural laws after independence just like the US, became newly industrialized countries. But it does not contain any former colony not having followed that path of institutional reform.

The major methodological economy of this sample is that it is identical to the one used by Boucekkine et al.'s 2010 analysis of the transaction cost benefit from codified default rules in substantive contract law. This chapter was able to complement Boucekkine et al.'s hypothesis, that the superior number of codified default rules in the contract laws of industrialized civil law countries compensated the financial center advantage of the UK and the US in the evolution of their GDP pc from 1870 to 2008 (DRH). DRH was incomplete without a corresponding hypothesis on procedural efficiency (PE), just like substantive law would remain dead letter as mere "law on the books" without being transformed into social and economic reality by effective civil procedure (PEH). Data for all 8 categories of rules and structures of civil procedure in the Louvain Questionnaire confirm PEH

for the civil law countries of the sample. Recent micro-economic analysis suggests, however, that the financial centers of our sample may have benefited from the inverse incentive structure of inefficient common law procedure, which tends to deter litigation from more risk-averse representatives of other sectors. But this aspect, too, is well reflected in the comparative performances of Switzerland, the UK and the US in Boucekkine et al.'s analysis and conclusions (Chap. 3). DRH is confirmed, if controlled for PE in both of its opposite incentive structures for industrial and financial sectors.

This result suggests important alternatives to consider for developing countries intent on autonomous legal reforms. If they hope to develop as financial centers, like the former English settler colony US or the former English "warehouse" economy Singapore (Lee 1960, 1972), they might favor lawyer-dominated judicial procedure. Inversely, if they wish to industrialize like France, Germany and Japan in the nineteenth century, or Korea and Taiwan in the mid-twentieth century, they will be better served by judge-managed civil procedure. If they hope for a composite economy with equally strong financial and industrial sectors, they might wish to opt for Switzerland's hybrid pattern.

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Part III
Overcoming the Legacies of Colonial Transplants of Common Law and Civil Law in Developing Countries and of Socialist Legal Origin in Transforming Countries

Chapter 6
Labour Law and Inclusive Development: The Economic Effects of Industrial Relations Laws in Middle-Income Countries

Simon Deakin, Colin Fenwick, and Prabirjit Sarkar

6.1 Introduction

There is an increasing interest among policy makers of the effects of labour law regulation on economic development, and a related growth in empirical research on this question. There remains, however, a lack of a clear consensus on the economic effects of labour laws. In part as a consequence of the influence of the World Bank's *Doing Business* reports (World Bank various years), policies of labour law deregulation have come to be identified, in some contexts at least, with the goal of enhanced labour market flexibility. The identification of regulation with inflexibility has however been challenged by the experience of countries which have adjusted their labour law systems to changing economic contexts, without removing, or in some cases even strengthening, social safety nets and wage floors. Strong and effective labour standards are, in general, correlated with greater earnings equality and with social cohesion (Freeman 2005). The evidence on the impact of labour laws on productivity and employment is more equivocal in the sense of indicating a wide range of possible outcomes, which vary across different country settings. A particular set of issues arises in relation to industrial relations laws, that is, laws that protect freedom of association, collective bargaining and the right to strike. An emerging literature suggests that laws promoting worker voice at enterprise level may have a positive impact on worker effort and morale and hence on

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efficiency, as well as being positively correlated with more equal distributional outcomes through the support they provide for collective bargaining (Deakin et al. 2014).

Most of the existing research on the economics of labour law relates, however, to developed countries, and there is a need to extend this type of analysis to consider the case of low and middle-income countries. This paper reports findings from a 'leximetric' study of the effects of changes in collective labour law from the early 1970s in five large middle-income economies, namely Brazil, China, India, Russia and South Africa. The study extends the existing dataset on labour regulation developed at the CBR in Cambridge (CBR-LRI Deakin et al. 2007). We present the results of econometric analysis on the incidence and magnitude of the contribution of labour law reforms in the areas of employee representation and industrial action law to changes in employment, and their impact on equality and related indicators of development. We find that reforms, which promoted collective employee representation in the workplace and strengthened the institutions of collective bargaining, reduced inequality and were positively correlated with indicators of human development in our sample countries. There is also evidence of a link between stronger laws relating to employee representation and the reduction of unemployment, suggesting an efficiency effect on the part of these laws. On the other hand, we find some evidence of positive correlations between industrial action laws, on the one hand, and inequality, on the other, and of a negative relationship between industrial action laws and developmental outcomes. We see some weak evidence of a disemployment effect of industrial action laws in our main regression analysis, but this is not replicated when we carry out robustness tests by altering the composition of the countries in the sample.

While our findings are therefore broadly consistent with earlier studies which identified the egalitarian effects of laws supporting collective bargaining, ours is the first study to extend this result to middle-income countries. Our findings also throw light on the view, associated with the World Bank, that the adoption of worker-protective labour laws in emerging markets will bring about inflexibilities or distortions in the operation of labour markets there. We see no evidence of this for worker representation laws, and only weak evidence, at best, in support of the World Bank view for industrial action laws.

To develop our argument, Sect. 6.2 below provides contextual information on the main reforms in collective labour laws in our sample countries over the period from the early 1970s to the present day. Section 6.3 then sets out our data sources and explains our 'leximetric' methodology for coding labour law rules and the approach taken in our econometric analysis. Section 6.4 presents our empirical results. Section 6.5 concludes.

6.2 Industrial Relations Laws in Middle-Income Countries: An Overview

Even though the principal contribution of the paper is the presentation of the data and its analysis, we think it nevertheless important to set, even if only briefly, the background and context in the five countries in the project. There are several reasons for this. First, a synthetic description of the legal systems and how they have changed provides important context for the trends that are depicted graphically below in our data analysis. Secondly, although our principal emphasis is on the data and its analysis, we do not argue that the data and its analysis alone can tell the whole story. A mixture of quantitative and qualitative approaches will produce a more nuanced understanding (Buchanan et al. 2013). Moreover, it is axiomatic in socio-legal analysis that there is always a difference between the form and content of legal rules, and their operation in practice (Deakin and Pistor 2011). Thus we also draw on the literature that analyses and contextualises labour regulation and industrial relations in each of the five countries.

A useful place to start is with freedom of association, which is constitutionally protected in each of the five countries (Brazil: Art. 8; China: Art. 35; India: Section 19(1)(c); Russia: Art. 30; South Africa: Arts. 18 and 23), although in different ways and to different effect. In Brazil the freedom to join a union is tempered by the operation of the *unicidade* system—itself enshrined in the 1988 Constitution—under which there may only be one trade union representing a particular category of workers in a geographical region. Thus, there is freedom whether or not to join a trade union, but once a worker makes such a decision, there is at best a limited choice of union available: in some cases the issue of the effective trade union monopoly is addressed by making the effort to register a new trade union. If there is already a trade union for that category of workers, this can only succeed by making the (sometimes artificial) effort to establish a new 'category' for the proposed union (Gomes and Prado 2011, p. 893).

In China, all unions must be affiliated to the All China Federation of Trade Unions (Brown 2006, p. 61); in this sense it is a commonplace that China does not protect freedom of association in the internationally accepted sense. But even more generally, it is necessary to approach the instantiation of constitutional rights in the Chinese legal context differently than elsewhere:

> A constitutional labour right in China does not confer on individuals a judicially enforceable entitlement against the state. It instead imposes a notional obligation on the state to create conditions under which individuals will enjoy the right (Cooney et al. 2013, p. 58).

In India, the constitutional protection of freedom of association supports the right to form and join a trade union. But it goes little further than this: the Supreme Court's interpretation of the constitutional provision is that the freedom does not include a right to collective bargaining, or a right to strike (Gopalakrishnan 2010). In Russia, the constitution protects not only the freedom of association—and so the right to form and join trade unions—but also the so-called 'negative' freedom of

association, that is, the right *not* to join an association (Lyutov 2009, p. 72). This leaves little scope for either agency or closed shop arrangements.

The right to strike is constitutionally protected in Brazil (Art. 9), where the right of workers to determine the timing and the goals of the strike arguably means that the right extends to political and sympathy strikes (Gacek 1994–1995, p. 76). Civil servants are guaranteed the right by Article 37 of the Constitution (Gacek 1994–1995, p. 77). The right to strike is protected in the constitution of Russia, where it includes a right to participate in a labour dispute (Art. 37) (Bronstein 2005, p. 303). The South African constitution protects the right to strike, and provides for agency and closed shop arrangements, as well as an organizational right to bargain collectively (Art. 23).

National constitutions also protect other labour rights and concerns for labour relations, even if they do not constitute specific provisions that require or establish particular industrial relations institutions. In Brazil the constitution protects in detail a wide range of working conditions (Arts. 6–8). India's constitution includes Principles of State Policy that extend to a right to work, to 'just and humane conditions of work', a living wage for workers, and the possibility of worker participation in the management of industries (Arts. 41–43A).

National legislation in each of the five countries builds on the constitutional protections, especially in the area of freedom of association, and facilitation of collective bargaining. In China the Trade Union Law provides certain support for the right of workers to form and join unions, and to participate in their activities, and also a measure of protection against acts of anti-union discrimination. It was the Trade Union Law of 1992 which introduced the possibility of regulation of working conditions by collective agreements, with later provisions introduced to provide specific guidance in the area (Brown 2006; Shen 2006). The bare skeleton established there was filled out by the provisions on collective agreements introduced in 2004. Collective agreements had been quite widespread in the 1950s, but their use ended with changes in ideological and policy orientation (Cooney et al. 2013, pp. 24–25).

Indian law provides to some extent for the exercise of a right to strike, and other important institutions, including the extension of collective agreements (Deakin and Sarkar 2011). Since 1982 Indian Law has included a concept of an unfair labour practice that operates, to some extent, as a form of duty to bargain collectively: redress for engaging in an unfair labour practice can be sought where, among other things, an employer refuses to bargain collectively (Mitchell et al. 2012, p. 14). Settlements to industrial disputes are binding on all workers, whether or not they are union members (Mitchell et al. 2012, p. 42). In some cases, enterprises with 100 or more employees must establish works councils (Mitchell et al. 2012, p. 43). On the other hand, the Trade Union Act was amended in 2001 to increase the minimum number of members required to register a trade union (Mitchell et al. 2012, p. 14).

Russia's Labour Code of 2002 provides for collective bargaining at different levels, allowing the bargaining parties to choose both the level of bargaining (Art. 37), and the topics (Art. 40). Agreements cover all workers in an enterprise, and there may only be one agreement per enterprise (Lyutov and Petrylaite 2009,

p. 796). At the enterprise level, where there are multiple unions they may bargain jointly, but have only 5 days to agree to do so, failing which a majority union may proceed to bargain independently (Rymkevitch 2003, p. 154), Moreover, at other levels, there is no procedural requirement for unions to attempt to work together: a majority union may simply proceed to bargain (Lyutov and Petrylaite 2009, p. 795). The right to strike is regulated by the Labour Code, although arguably the procedural requirements have the effect of stifling the potential for lawful industrial and strike action (Lyutov 2011, p. 937).

South Africa's Labour Relations Act 1995 provides an elaborate and sophisticated framework for the exercise of the rights to freedom of association, to strike, and to bargain collectively. A union that is sufficiently representative may exercise certain organisational rights. Disputes over whether or not a union is sufficiently representative may be resolved by the Commission for Conciliation, Mediation and Arbitration (CCMA). Building on a tradition with origins in the 1920s, South Africa's post-apartheid labour relations laws place an emphasis on sectoral bargaining, through the vehicle of bargaining councils. To be formed at the volition of employers and unions in particular sectors, bargaining councils have power to determine conditions, to enforce compliance with them, and to extend their operation to employers and employees working in the same sector, but who are not members of the bargaining council. Where bargaining is not successful, and neither is conciliation, the parties may take direct industrial action (strikes and lockouts); workers on strike or who are locked out may not be permanently replaced with newly-hired workers. Moreover, workers may take protected secondary or sympathy strike action, subject to certain conditions (Du Toit et al. 2006, pp. 6–15).

Having briefly outlined a little of the relevant legal systems, we turn to how these systems have changed, and to evidence on how they work in practice. In our view, it is essential to pay attention to change and development in legal systems over time, rather than to look at rules at a fixed point in time: for example, if laws (institutions) have not changed, then the explanation for economic phenomena may lie elsewhere (Deakin and Sarkar 2011). Secondly, as noted, looking at the content and form of legal rules alone can give only an incomplete explanation for other phenomena. This is not to say that actors do not respond to the economic incentives set by legal rules. It is merely to acknowledge that the rules alone cannot provide a complete explanation. Indeed in some contexts, they may explain very little, for example because it can be so difficult to identify them. In China, for example, the national level laws leave much to other levels of government, and to other forms of regulation (Cooney et al. 2013).

In Brazil the biggest change during the period under review came with the Constitution of 1988, which included a new provision prohibiting state interference in the affairs of trade unions. This altered a key element of the corporatist model of trade unionism first developed in the 1930s (Cook 2002, p. 9). At the same time, the 1988 Constitution broadened the scope of the constitutional protection of the right to strike, which had until then been quite severely curtailed, including by reliance

on a very expansive concept of 'essential services', in which strikes were prohibited (Gacek 1994–1995, pp. 77–78). Thus in our terms, labour law in the areas that we are presently considering became more protective.

Yet Brazil's labour law is quite restrictive of workers' exercise of the freedom of association: the 1988 Constitution preserved the system of *unicidade*, and the associated requirement that all workers who work in a category and territory where a union is registered, must make a financial contribution to the union. These funds are collected by the state, and distributed to unions at different geographical levels according to a formula. Arguably this leads to unions that are more responsive to the compulsory financial contribution—and the state's role in the maintenance of the system—than to the interests of their worker members (Gomes and Prado 2011). Efforts have been made to change the system since soon after the adoption of the 1988 Constitution (Cook 2007, 2002). The Lula government established a process that led to a draft law being submitted to Congress in 2005, but to date it remains unadopted (Gomes and Prado 2011). This is largely because of the interests that smaller, less representative unions have in the maintenance of the system, and certain employer organisations that have the same interest. The system, however, is not necessarily conducive to free collective bargaining that effectively represents workers' interests, and that could focus also on improving enterprise performance and productivity.

Changes in Chinese labour law during the period under review have focussed predominantly on regulation of individual relations, through the Labour Law of 1994, and the subsequent Labour Contract Law of 2008 (the longer-run history, and the legal and political context, are explored in Cooney et al. 2013). But there have also been important changes in the laws relating to the functioning of industrial relations institutions: the Trade Union Law 1992 (revised in 2001) included an important foundation for negotiation and conclusion of collective agreements. But despite the features of Chinese law on freedom of association and trade unions that are similar to those in liberal market economies, the role of unions in China is still predominantly focused on fulfilling their traditional—and still legislatively-mandated—role of mediating between workers and management (Clarke et al. 2004; Zhu et al. 2011). Moreover, the ability of unions to fulfil a more independent role as a free agent in collective bargaining on behalf of their worker members is compromised by the involvement of management in unions, and unions' lack of experience in operating autonomously (Cooney et al. 2013, p. 81). On the other hand, while unions in China are not seen (including by workers) as autonomous representatives of workers' interests, it is nonetheless true that as China has changed its labour market regulation model over the last 20 years, the trade union movement—through the ACFTU—has been a significant and effective advocate for laws that provide better protection for workers (Zhu et al. 2011, p. 138).

In India, even a cursory attempt to develop a contextual analysis of labour regulation shows the difficulty in drawing conclusions from the form and content of legal systems alone: on most analyses only 7 % of workers in India are covered by the formal system of labour regulation. Despite this, the argument persists that labour regulation needs to be revised to reduce obstacles to further economic

growth and improved development. Two of the present three authors have already shown that Indian labour regulation in general has no adverse effect on levels of unemployment. In fact, the causality is in the other direction: periods of lower unemployment have led to greater levels of legal protection (Deakin and Sarkar 2011). Moreover, while Indian labour regulation is arguably more protective in the area of protection of individual employment than it is in many countries, the level of protection in its regulation of collective labour relations—that is, of industrial relations institutions—is more or less average by international standards (Deakin and Sarkar 2011; for an attempt to test empirically the actual strength in practice of these laws, see Badigannavar and Kelly 2012). When it comes to trade unions and collective bargaining in India, the literature suggests that trade unions have only ever represented a very small proportion of workers in India, and that collective bargaining is largely confined to public sector institutions (Mitchell et al. 2012, p. 15). Indian unions do have a degree of political significance, but this derives from the relationships between unions and political parties, rather than from any strength in their membership base that politicians feel it necessary to consider.

Moreover, the Indian state has retained a model of state control of industrial relations that originated in British colonial rule, with a desire to maintain control of workers and production. Following independence the system was maintained in the interests of pursuing national development (Mitchell et al. 2012, p. 12). In any event, the Industrial Disputes Act 1947 still includes provisions that give to government the power to intervene in collective disputes, and to choose whether or how they will be resolved (whether by conciliation or adjudication). It was only in 2010 that the Act was amended to provide that individuals could take their disputes to resolution without first obtaining government authorisation.

Russian law on labour relation has undergone dramatic shifts. As in China, trade unions in Soviet Russia were instruments of the state, intended to serve a 'transmission belt' function between the state and workers. The first trade union central was established in Russia in 1933, following the liquidation of the former Ministry of Labour (Lyutov 2011, p. 934). Thereafter, the trade unions played an important role in delivering and managing social services for workers, but they did not operate as workers' representatives, nor was there any form of collective bargaining. At the fall of the Soviet Union, the trade union central was, effectively, privatised, with its vast assets being transferred to the new independent trade union federation that succeeded its Soviet-era predecessor (Lyutov 2011, p. 935). Under the new Labour Code, the emphasis is on a model of tripartite social partnership, in order to mark a clear differentiation from the former system (Olimpieva 2012, p. 273). At transition, new independent unions began to emerge, but they were then, and are now, more or less powerless to match the experience and, more importantly, the resources of the former monopoly trade union. Given the way the Labour Code operates, the structural situation has changed relatively little. As there can now be only one collective agreement in an enterprise, and as the majority union can go ahead to bargain without the other unions participating, and as the outcome covers all workers, there is little scope for new unions to find a place in the industrial relations scheme (Rymkevitch 2003, p. 154). There are other advantages in the

scheme for the majority union, including the provisions protecting trade union leaders from dismissal without trade union permission: these are only likely to be effective for the leaders of those unions that have a significant presence in the workplace, as these are the only ones likely to have sufficient members to be able to make use of the relevant procedures (Lyutov and Petrylaite 2009, pp. 792–793).

As previously noted, of the systems considered in this paper, South Africa's is the one designed most to support a system of autonomous collective bargaining. Not surprisingly, the level of protection in this aspect of the system sees South Africa ranked at the higher end of the scale in this area of labour regulation (Bhorat and Cheadle 2009; see also Sect. 6.3 below). But in the area of collective labour relations, the outcomes have been very different than perhaps were hoped for in the transition from apartheid. Collective bargaining is relatively little established outside the bargaining councils, and is often characterized by increasing fragmentation of bargaining units. Thus industrial relations are becoming more decentralized, despite the deliberate policy choice by those establishing the system to put the emphasis on sectoral mechanisms (Leibbrandt et al. 2010, p. 25). One consequence is that collective bargaining may be having less distributional effect across the workforce, while relations at the workplace (which the system design hoped would deal with issues like skills and productivity) have become less effective (Budlender 2009, p. 10). Indeed, at the enterprise level industrial relations are arguably becoming more conflictual, reflecting in part the historical orientation of unions in South Africa to conflict, in order to pursue the struggle to combat apartheid. The weaknesses of the formal legal regulation of collective labour relations, and of some of the actors in the industrial relation system, can be seen in the fact that recent high profile industrial disputes have been characterized by violence, including by police shooting striking miners (Benjamin 2013).

It should also be noted that in South Africa very large numbers of workers fall outside the system of legal regulation of labour relations. 'Externalisation' of labour relations has been a significant feature of the labour market over the last 15–20 years, including through the use of agency work (known as 'labour broking' in South Africa), sub-contracting and casualization (Theron 2011, pp. 11–12). Official data show fewer workers in the informal economy than might be expected, but this more likely reflects obstacles to entry to informal employment, rather than a lower level of this form of work compared to comparable countries (Davies and Thurlow 2010, p. 437). Moreover, legal innovations to address the issue of the diminishing scope of legal regulation of the employment relationship have been of little effect (Theron 2011, p. 12).

The purpose of this section has only been to give a flavour of the five systems under consideration, and of their differences and similarities. Among other things, it shows the need to recall that states have pursued, and continue to pursue, political as well as economic interests in their design of labour market regulation. Most starkly in the current context, trade unions in Russia were, and in China still are, instruments of the state itself. In Brazil the corporatist system is closer to that end of the continuum than to one characterized by full enjoyment of the freedom of association. India continues to maintain a high degree of control of trade union activity.

South Africa's turn to democracy brought an end to decades of institutionalised racial discrimination and differentiation between groups of workers, and amounts to the greatest shift among the five countries considered here. But the almost 20 years of the new labour relations system have arguably had limited effect on overcoming that historical legacy and the inequalities that apartheid fostered. So much we can say of these five countries by drawing on literature in law, industrial relations, development and political economy, to set a context for the empirical analysis. It is to this that we now turn.

6.3 Leximetric Coding: Techniques and Data

So-called leximetric coding techniques are designed to produce data on features of legal systems in a form, which can be used in quantitative analysis (Botero et al. 2004; Deakin et al. 2007). Coding proceeds in a series of steps: (1) identification of relevant indicators; (2) definition of a coding algorithm or protocol to be used in allocating values to particular laws; (3) retrieval of primary data in the form of texts of statutes, judicial decisions and other relevant regulatory sources; (4) analysis of the primary data using the specified coding algorithms, to arrive at values or scores for individual indicators; (5) aggregation or averaging of the resulting values into composite scores for indices or sub-indices representing a given body of law in a particular jurisdiction. This is followed by a further stage, (6) econometric analysis of the data alongside data for other variables of interest, such as labour market data of various kinds (including employment and unemployment data, and inequality, poverty and developmental indicators).

The CBR-LRI index divides industrial relations laws into two main areas, worker representation laws (covering both collective bargaining laws and employee information and consultation laws) and strike laws (or laws governing industrial action). Each of these two main sub-indices is disaggregated into a number of individual indicators, corresponding to particular types of legal rules. Each indicator has a coding algorithm, which sets out the process for allocating scores to particular variables (see Tables 6.1 and 6.2). A 0–1 scale is used, with higher scores indicating a higher degree of worker protection.

The choice of indicators in the CBR-LRI is based on broadly-held understandings among labour law experts of the more important types of rules protecting workers and trade unions in relation to collective representation and industrial action. It also reflects, in broad terms, the subject-matter of relevant ILO conventions and recommendations on these issues. When it comes to aggregating the values for particular laws, and combining them into composite scores for a wider area of law, difficult issues of weighting arise. If no weighting is used, the implicit assumption being made is that each of the individual indicators is of equivalent importance in determining the overall score arrived at in the relevant composite index or sub-index. This assumption may be questioned, since it is possible that the relative importance of a given indicator may not be the same at all times and in all

Table 6.1 Indicators and coding algorithms in the employee representation laws sub-index

Indicator	Algorithm
Right to unionisation	Measures the protection of the right to form trade unions in the country's constitution (loosely interpreted in the case of system such as the UK without a codified constitution). Equals 1 if a right to form trade unions is expressly granted by the constitution. Equals 0.67 if trade unions are described in the constitution as a matter of public policy or public interest. Equals 0.33 if trade unions are otherwise mentioned in the constitution or there is a reference to freedom of association which encompasses trade unions. Equals 0 otherwise. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Right to collective bargaining	Measures the protection of the right to collective bargaining or the right to enter into collective agreements in the country's constitution (loosely interpreted in the case of system such as the UK without a codified constitution). Equals 1 if a right to collective bargaining is expressly granted by the constitution. Equals 0.67 if collective bargaining is described as a matter of public policy or public interest (or mentioned within the chapter on rights). Equals 0.33 if collective bargaining is otherwise mentioned in the constitution. Equals 0 otherwise. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Duty to bargain	Equals 1 if employers have the legal duty to bargain and/or to reach an agreement with unions, works councils or other organizations of workers Equals 0 if employers may lawfully refuse to bargain with workers. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Extension of collective agreements	Equals 1 if the law extends collective agreements to third parties at the national or sectoral level. Extensions may be automatic, subject to governmental approval, or subject to a conciliation or arbitration procedure. Equals 0 if collective agreements may not be extended to non-signatory workers or unions, or if collective agreements may be extended only at the plant level. Mandatory administrative extensions of collective agreements are coded as equivalent to mandatory extensions by law. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Closed shops	Equals 1 if the law permits both pre-entry and post-entry closed shops. Equals 0.50 if pre-entry closed shops are prohibited or rendered ineffective but post-entry closed shops are permitted (subject in some cases to exceptions e.g. for pre-existing employees). Equals 0 if neither pre-entry nor post-entry closed shops are permitted to operate. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law

(continued)

Table 6.1 (continued)

Indicator	Algorithm
Codetermination: board membership	Equals 1 if the law gives unions and/or workers to right to nominate board-level directors in companies of a certain size. Equals 0 otherwise. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Codetermination and information/ consultation of workers	Equals 1 if works councils or enterprise committees have legal powers of co-decision making. Equals 0.67 if works councils or enterprise committees must be provided by law under certain conditions but do not have the power of co-decision making. Equals 0.5 if works councils or enterprise committees may be required by law unless the employer can point to alternative or pre-existing alternative arrangements. Equals 0.33 if the law provides for information and consultation of workers or worker representatives on certain matters but where there is no obligation to maintain a works council or enterprise committee as a standing body. Equals 0 otherwise. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law

systems. However, it is difficult to apply a priori weights to individual indicators in a way that would get round this problem for particular countries or time periods, without introducing a new element of subjectivity into the analysis. As labour law systems consist of interlocking rules, each of which contributes to the operation of the system as a whole, an assumption of equal weighting is arguably the best default position to take. Changes to weights can be made to test particular hypotheses concerning the salience of particular laws in given country contexts.

Figures 6.1 and 6.2 represent in graphical form the main trends in our two sub-indices for the five countries in the sample and, by way of comparison, Figures 6.3 and 6.4 present equivalent data for a range of developed economies. Russian data are coded from 1994, the first full year of the operation of the Constitution of the Russian Federation. The data are presented as 5-yearly averages. Certain trends stand out. Chinese law, formally at least, became somewhat less protective over time. The 1992 Trade Union law replaced provisions in the earlier 1950 law which were formally more protective of trade unions' collective bargaining and co-decision making rights. In addition, the 1982 Constitution removed references to the right to strike, which had been contained in the Constitutions of 1975 and 1978. Whether these changes made a difference of substance to the operation of the law may be doubted. Although, as we noted above, collective agreements were in place in parts of the Chinese economy in the 1950s, collective wage determination was more or less in abeyance from the early 1960s onwards. Nor is it clear, as we saw (see Sect. 6.2 above), what significance should be attached to constitutional labour rights in the Chinese context, given the absence of mechanisms for asserting them through the court system.

Table 6.2 Indicators and coding algorithms in the industrial action laws sub-index

Indicator	Algorithm
Unofficial industrial action	Equals 1 if strikes are not unlawful merely by reason of being unofficial or 'wildcat' strikes. Equals 0 otherwise. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Political industrial action	Equals 1 if strikes over political (i.e. non work-related) issues are permitted. Equals 0 otherwise. Scope for gradations between 0 and 1 to reflect changes in the strength of the law
Secondary industrial action	Equals 1 if there are no constraints on secondary or sympathy strike action. Equals 0.5 if secondary or sympathy action is permitted under certain conditions. Equals 0 otherwise. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Lockouts	Equals 1 if lockouts are not permitted. Equals 0 if they are. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Right to industrial action	Measures the protection of the right to industrial action (i.e. strike, go-slow or work-to-rule) in the country's constitution or equivalent. Equals 1 if a right to industrial action is expressly granted by the constitution. Equals 0.67 if strikes are described as a matter of public policy or public interest. Equals 0.33 if strikes are otherwise mentioned in the constitution. Equals zero otherwise. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Waiting period prior to industrial action	Equals 1 if by law there is no mandatory waiting period or notification requirement before strikes can occur. Equals 0 if there is such a requirement. Scope for gradations between 0 and 1 to reflect changes in the strength of the law
Peace obligation	Equals 1 if a strike is not unlawful merely because there is a collective agreement in force. Equals 0 if such a strike is unlawful. Scope for gradations between 0 and 1 to reflect changes in the strength of the law
Arbitration	Equals 1 if laws do not mandate conciliation procedures or other alternative-dispute-resolution mechanisms (other than binding arbitration) before the strike. Equals 0 if such procedures are mandated. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law
Replacement of striking workers	Equals 1 if the law prohibits employers to fire striking workers or to hire replacement labour to maintain the plant in operation during a non-violent and non-political strike. Equals 0 if they are not so prohibited. Scope for further gradations between 0 and 1 to reflect changes in the strength of the law

These caveats aside, Figs. 6.1 and 6.3 suggest that China has, over the period studied, generally provided a lower degree of legal protection for workers' representation and industrial action rights than the other countries in the sample. Brazil and India have levels of protection, which are as high as the most protective

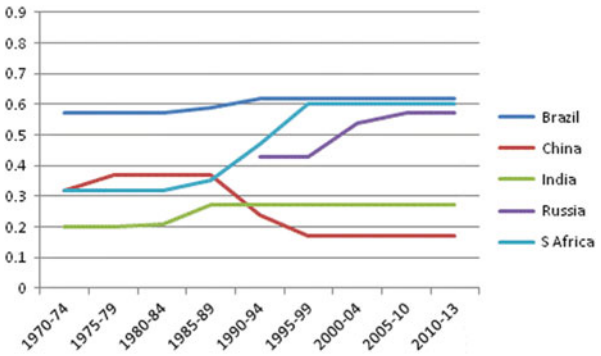

Fig. 6.1 Employee representation laws in developing countries. *Source*: CBR Labour Regulation Index

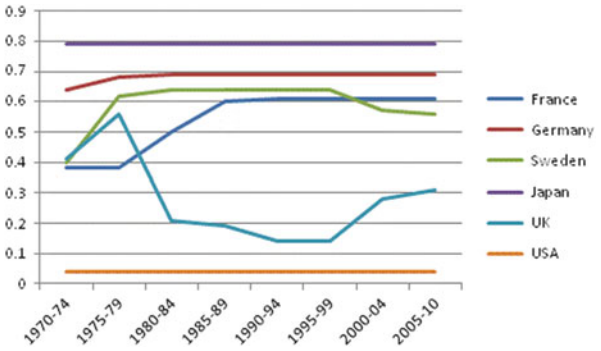

Fig. 6.2 Employee representation laws in developed countries. *Source*: see Fig. 6.1

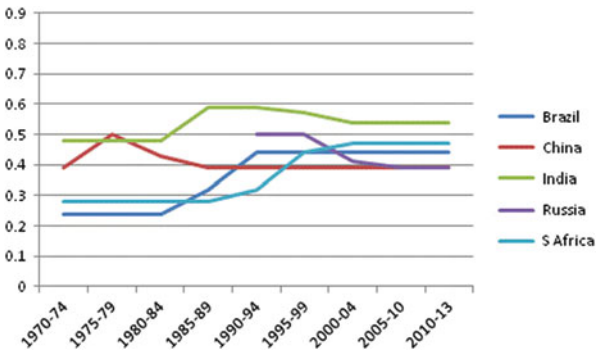

Fig. 6.3 Industrial action laws in developing countries. *Source*: see Fig. 6.1

developed country systems. The rising trend of protection in South Africa since the end of the Apartheid period is also clearly represented in Figs. 6.1 and 6.2.

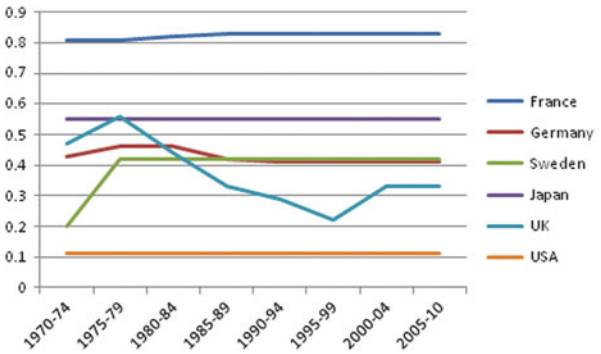

Fig. 6.4 Industrial action laws in developed countries. *Source*: see Fig. 6.1

6.4 Labour Market Data and Econometric Analysis

The data coded in the CBR-LRI relate to formal laws, that is to say, "laws on the books" derived from legislative and judicial texts and, where relevant, from collective agreements or other sources of regulation which are meant to have a binding effect equivalent to that of a statutory or judicial text. No assumption can be made from the scores in the index of the actual effects of laws. It is only through econometric analysis that any basis can be found for evaluating these consequences. Econometric analysis makes it possible to test for relationships of correlation and, up to a point, of causation, between variables of interest: an independent or causal variable, on the one hand, and a dependent or outcome variable, on the other. Here, we are interested in testing for possible correlations between legal regulation (the causal variable) and a number of measures of economic performance (the outcomes variables). We control for the country level growth-rate of real GDP and for the effectiveness of enforcement of legal rules as measured by the World Bank's rule of law index.

Single country studies, although of some interest, are by their nature liable to be unrepresentative of the potential effects of laws on economic outcomes, and so it is preferable to undertake a panel data analysis, which pools data from a range of different national systems. Alternative regression models can be used in order to take account of cross-country and cross-time heterogeneity, which is not fully captured in the data. Fixed-effects models (FE) control for omitted variables that may be expected to differ across countries but are constant over time. Random effects models (RE) control for omitted variables that may be expected to vary over time and which may also vary across countries.

There are distinct problems involved in seeking to analyse the relationship between legal change and economic outcomes in developing countries. The gap between "law on the books" and "law in action" is likely to be more significant in emerging market contexts where legal institutions are generally less well developed than in industrialised countries. However, this can be addressed by the inclusion of the rule of law variable in the regression analysis; this in effect controls for the effectiveness of enforcement of "law on the book". Secondly, labour market data

may only reflect the experience of the segment of the workforce, possibly a minority that is, the part of employed in the formal sector. This in itself does not invalidate econometric analysis of the effects of laws on economic outcomes, since what is being measured is the impact of legal regulation on precisely those groups in the workforce which are most likely to be affected by legal regulation. The limited scope of labour market data in emerging markets does, nevertheless, stress the need for particular caution in interpreting findings from econometric analysis. A further point is that time series data are more limited for emerging markets than they are in the case of developed economies. The data sources that we use—ILO data on unemployment, Gini coefficient data for inequality, and the Human Development Index for developmental indicators—are less extensive and less complete in the case of emerging markets than they are for the more developed economies, for which OECD data provide extended time series. For this reason, our econometric analysis is confined to the period from the early 1990s.

Table 6.3 reports our results for employee representation laws. We find, firstly, that a higher score in the worker representation sub-index is inversely correlated with the Gini coefficient in the FE model which, according to the Hausman test, is to be preferred in this case. This implies that as the law in this area becomes more protective of worker rights, inequality declines. Secondly, the worker representation law is positively correlated with values in the Human Development Index in both the FE model and the RE model. This suggests that these laws are related to beneficial developmental outcomes. We also find a negative relationship between employee representation laws and unemployment levels in the FE model, although not in the RE model; however, the Hausman test indicates the result from the FE is to be preferred here.

Table 6.4 reports the results for industrial action laws. In contrast to the findings on employee representation, there is some evidence of negative effects of worker protective laws on equality, human development and employment. However, the magnitudes here are small, as indicated in particular by the very low R^2s for the Gini coefficient and unemployment correlations.

In order to test whether these findings are a contingent result of the sample we are using, we conduct further analyses, dropping one country at a time from the sample, and comparing the outcomes generated by the fixed-effects and random-effects models, respectively, in each case. The results are summarised in Table 6.5 and the full analysis is set out in detail in the Appendix.

In the case of employee representation laws, the one result that is consistently reproduced across all tests is the positive correlation between worker rights and scores on the HDI. The results for the Gini coefficient continue to suggest that employee representation laws contribute to a reduction in inequality, but because the FE and RE models point in different directions in most of the regressions, this finding must be regarded as a qualified one. The results for the unemployment variable also indicate a range of outcomes, suggesting that there is no clear evidence of an effect, either positive or negative, of this type of law.

With regard to industrial action laws, the clearest finding is that these laws are correlated with a decline in the HDI score. The results for the Gini coefficient are

Table 6.3 Labour market effects of employee representation laws

Independent variables	Dependent variables					
	Inequality		Human development		Unemployment	
	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.08098	−0.2311	0.0003	−0.0006	0.0065	−0.2978*
Rule of law	−3.7494	1.2973	−0.0092	−0.1651	12.2152	4.5874
Worker representation laws	−37.9085**	11.6790	0.4470**	0.1850***	−27.1831**	13.3212
R^2	0.4489	0.4375	0.1962	0.7837	0.0107	0.4756
Chosen model	FE		FE			RE

Sources: World Bank (Gini Coefficient and Rule of Law Index), UNDP (Human Development Index), ILO (unemployment)
Significant at the 10 % level (*), 5 % level (**), 1 % level (***)

Table 6.4 Labour market effects of industrial action laws

Independent variables	Dependent variables					
	Inequality		Human development		Unemployment	
	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.0573	−0.2348	0.0001	0.0008	0.2442	0.1283
Rule of law	−3.6032	2.9543	0.0110	−0.04864	16.4779	8.4732
Industrial action laws	56.4779***	24.7123	−0.5145**	−0.7874***	84.0592	72.1090*
R^2	0.0641	0.4322	0.5583	0.7401	0.1905	0.1916
Chosen model	FE		FE			RE

Sources: see Table 6.3
Significant at the 10 % level (*), 5 % level (**), 1 % level (***)

mixed, suggesting no clear relationship between industrial action laws and inequality, while those for unemployment mostly point to the absence of any effect, positive or negative, of these laws.

6.5 Discussion and Conclusion

Richard Freeman has suggested that "while proponents and opponents of the case against labour institutions disagree about whether labour institutions are a significant contributor to unemployment and aggregate economic efficiency, it is important to recognize that they concur on one point: that labour institutions, particularly those associated with trade unions, reduce inequality of pay compared to pay in competitive markets". He goes on to note that this proposition is broadly accepted for industrialised countries, "the situation is more ambiguous in developing countries since unions do not represent workers in the informal sector and rarely represent rural workers, who are paid less than those in the modern sector" (Freeman 2005, p. 11). In this chapter we have sought to advance empirical

Table 6.5 Labour market effects of labour laws: summary of robustness tests

(a) Employee representation laws			
Variables	FE model	RE model	Choice of model by Hausman test
Gini coefficient			
Excluding Brazil	Gini declines	Gini rises	FE
Excluding China	Gini declines	Gini rises	FE
Excluding India	Gini declines	Gini rises	FE
Excluding Russia	Gini rises	Gini rises	RE
Excluding South Africa	Gini declines	Gini rises	FE
Full sample	Gini declines	No effect	FE
HDI			
Excluding Brazil	HDI rises	HDI rises	FE
Excluding China	HDI rises	HDI rises	FE
Excluding India	HDI rises	HDI rises	FE
Excluding Russia	HDI rises	HDI rises	FE
Excluding South Africa	HDI rises	HDI rises	FE
Full sample	HDI rises	HDI rises	FE
Unemployment			
Excluding Brazil	Unemployment falls	Unemployment rises	RE
Excluding China	Unemployment falls	Unemployment rises	FE
Excluding India	Unemployment falls	Unemployment rises	RE
Excluding Russia	No effect	Unemployment rises	FE
Excluding South Africa	Unemployment falls	Unemployment rises	FE
Full sample	Unemployment falls	No effect	FE
(b) Industrial action laws			
Variables	FE model	RE model	Choice of model by Hausman test
Gini coefficient			
Excluding Brazil	Gini rises	No effect	FE
Excluding China	Gini rises	No effect	FE
Excluding India	Gini rises	Gini rises	RE
Excluding Russia	No effect	No effect	RE
Excluding South Africa	Gini rises	No effect	FE
Full sample	Gini rises	No effect	FE
HDI			
Excluding Brazil	HDI declines	HDI declines	RE
Excluding China	HDI declines	HDI declines	RE
Excluding India	HDI declines	HDI declines	RE
Excluding Russia	No effect	HDI declines	RE
Excluding South Africa	HDI declines	HDI declines	FE
Full sample	HDI declines	HDI declines	FE

(continued)

Table 6.5 (continued)

(b) Industrial action laws			
Variables	FE model	RE model	Choice of model by Hausman test
Unemployment			
Excluding Brazil	No effect	No effect	RE
Excluding China	No effect	No effect	RE
Excluding India	No effect	Unemployment rises	RE
Excluding Russia	No effect	No effect	RE
Excluding South Africa	No effect	No effect	RE
Full sample	No effect	Unemployment rises	RE

understanding of these issues in two ways. Firstly, we have used leximetric data coding to analyse the role of laws supporting industrial relations institutions: laws supporting worker representation in the workplace and at industry level, and laws protecting the right to take industrial action. Secondly, we have applied these leximetric coding techniques to a sample of larger middle-income countries—Brazil, China, India, Russia and South Africa—thereby extending our knowledge of the effects of labour laws beyond the developed economies which have up to now been the focus for most econometric research in this area.

Our results suggest that an emerging finding to the effect that laws supporting employee representation contribute to more egalitarian labour market outcomes holds for the developing world, just as they do, according to other studies, in the developed world (Sarkar 2013; Deakin et al. 2014). This is clearest in the consistently positive correlation between employee representation laws and scores on the Human Development Index. There is weaker evidence of an inverse correlation between employee representation laws and the Gini coefficient, suggesting that these laws are associated with a reduction in inequality. When the full sample of BRICS countries is analysed there is a negative correlation between employee representation laws and unemployment, but this result is not consistently reproduced across the differently composed samples.

In the case of industrial action laws, we find evidence of a link between a higher level of worker protection with respect to the right to strike, and a lower score on the HDI, the opposite of the finding for employee representation laws, although as noted in Sect. 6.4 above, the magnitudes involved here are small. In the case of the Gini coefficient, there is some weak evidence of a positive correlation with industrial action laws (indicating that a higher score here is correlated with more inequality) but this is not reproduced across all tests. In the case of the unemployment variable, most of the regressions report no effects either way of the law.

Our study is limited, as all such studies are, by the confined nature of leximetric data, which only code for formal laws and regulations, and by the lack of long time series for labour market data in emerging markets, by comparison to industrialised countries. Cross-country panel data analyses of the kind we have presented also suffer from the tendency to gloss over within-country differences operating at firm and sector level. Thus our findings would need to be complemented by analysis of

firm-level and sector-level effects in order to be regarded as more widely generalizable. As always with econometric research, there is a role for case studies and qualitative research in validating the results from statistical analysis, and in clarifying relationships of cause and effect, as opposed to simple correlation.

Notwithstanding these caveats, the present study adds to a growing body of empirical work with a clear message: strong industrial relations institutions, supported by labour laws underpinning worker voice and collective bargaining, can help reduce inequality and promote developmental outcomes in emerging markets, just as they do in industrialised countries. Conversely, the case against labour laws in emerging markets, namely that they induce rigidities in labour markets which lead to unemployment, is not supported by the empirical evidence we have presented here. Future research should seek to identify more precisely the social and economic effects of particular laws, building on the analysis presented here which suggests some degree of divergence in the effects of employee representation laws and industrial action laws respectively.

Appendix

See Tables 6.6 and 6.7.

Table 6.6 Labour market effects of laws concerning employee representation: alternative samples

(a) Excluding Brazil[a]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.3353	−0.2430	0.0012	0.0014	0.0509	−0.2011*
Rule of law	−6.1679	15.5493	0.1240	0.0151	16.4839	8.8027
Worker representation laws	−41.1248**	29.9058**	0.1884*	0.0497***	−31.1692**	31.1687***
R^2	0.3494	0.6191	0.2918	0.8421	0.0076	0.6635
Chosen model	FE		FE			RE

(b) Excluding China[b]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.0476	−0.3464	−0.0002	−0.0013	0.0042	−0.2837
Rule of law	−2.3880	17.8504***	−0.0143	−0.1432***	16.7735	9.4036***
Worker representation laws	−44.1906***	77.3019***	0.4315**	0.3426***	−29.6548**	36.0603***
R^2	0.5091	0.0842	0.6926	0.9205	0.0699	0.4106
Chosen model	FE		FE		FE	

(c) Excluding India[c]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.0810	−0.0923	0.0002	−0.0013	0.0209	−0.2063
Rule of law	−3.7494	21.8977	0.0687	−0.1284	12.3234	12.7685***
Worker representation laws	−37.9085**	28.4672***	0.3413**	0.0927*	−27.8611**	17.2021***
R^2	0.4136	0.8256	0.0048	0.6777	0.0002	0.6067
Chosen model	FE		FE			RE

(d) Excluding Russia[d]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.0277	−0.2660	0.0015	0.0019	0.1911	1.4129***
Rule of law	−5.7167	2.4859	0.0057	−0.2155***	12.8429	15.3716***
Worker representation laws	116.8887***	42.0734***	1.5552***	0.2435***	270.7476	42.8163***
R^2	0.8005	0.8041	0.1413	0.7197	0.4562	0.6320

(continued)

Table 6.6 (continued)

Chosen model (e) Excluding South Africa[e]	FE		FE		FE	
	Dependent variables					
Independent variables	Inequality		Human development		Unemployment	
	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.2949**	17.7098***	0.0005	−0.0005	−0.1288**	−0.3163***
Rule of law	−17.7094	−0.2212	0.0128	−0.1587***	−1.9493	−2.6653***
Worker representation laws	−28.7776*	36.7612***	0.4524**	0.1986***	−19.8887***	5.0556***
R^2	0.5168	0.6160	0.3751	0.7765	0.4291	0.8157
Chosen model	FE		FE		FE	

[a]*Sources*: World Bank (Gini Coefficient and Rule of Law Index), UNDP (Human Development Index), ILO (unemployment), CBR Labour Regulation Index (employee representation laws). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if Brazil is excluded, unemployment rises; other results are unchanged.

[b]*Sources*: see Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if China is excluded, the results are unchanged.

[c]*Sources*: see Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if India is excluded, unemployment rises; other results are unchanged.

[d]*Sources*: see Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if Russia is excluded, inequality rises and there is no unemployment effect. HDI rises as before.

[e]*Sources*: World Bank (Gini Coefficient and Rule of Law Index), UNDP (Human Development Index), ILO (unemployment), CBR Labour Regulation Index (employee representation laws). See Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: excluding South Africa makes no difference to the results.

Table 6.7 Labour market effects of laws concerning industrial action: alternative samples

(a) Excluding Brazil[a]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.0062	−0.7079	−0.0004	0.0053	0.2941	−1.0881
Rule of law	−6.3087	16.5899	−0.0413	−0.1231	20.5022	9.1684
Industrial action laws	61.3271**	−37.2344	−0.6051*	−0.6187***	87.1592	−15.0145
R^2	0.0284	0.4891	0.8167	0.8934	0.1916	0.3751
Chosen model	FE			RE		RE

(b) Excluding China[b]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.04763	−0.6135	−0.0002	0.0006	0.2450	−0.3979
Rule of law	−2.3880	22.1940***	−0.0143	−0.0629**	20.9050	10.1287**
Industrial action laws	56.8165***	−66.2362	−0.5547**	−1.3033***	85.2598	−31.5968
R^2	0.066	0.5063	0.9112	0.9171	0.1534	0.2367
Chosen model	FE			RE		RE

(c) Excluding India[c]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.0573	−0.02368	0.0000	−0.0051***	0.3589	0.1331
Rule of law	−3.6032	13.2102	0.0714	−01109***	17.9791	9.5812***
Industrial action laws	56.4779***	144.5994***	−0.3720***	−0.2919*	97.6719	128.5135***
R^2	0.1900	0.7968	0.3164	0.6545	0.6073	
Chosen model		RE		RE		RE

(d) Excluding Russia[d]

	Dependent variables					
	Inequality		Human development		Unemployment	
Independent variables	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.0632	−1.9862	0.0011	−0.0082***	−0.2705	−1.0368
Rule of law	6.4909	5.6972	0.0053	−0.0735*	3.1518	25.8144
Industrial action laws	dropped	−37.6127	dropped	−0.8998***	180.9812	−83.0133
R^2	0.0746	0.5930	0.1375	0.7228	0.1573	0.4399
Chosen model		RE		RE		RE

(continued)

Table 6.7 (continued)

(e) Excluding South Africa[e]

Independent variables	Dependent variables					
	Inequality		Human development		Unemployment	
	FE model	RE model	FE model	RE model	FE model	RE model
GDP growth	−0.2639**	−0.8482	0.0004	−0.0065***	−0.1835	−0.3863***
Rule of law	−17.1354	14.6248***	0.1462	−0.1089***	−3.8663	−4.2480***
Industrial action laws	45.1266***	−6.7940	−0.5202**	−0.7172***	18.0880	8.8190
R^2	0.0641	0.3529	0.5076	0.8074	0.7008	0.7574
Chosen model	FE		FE			RE

[a]*Sources*: see Appendix Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if Brazil excluded there is no unemployment effect; other results are unchanged.
[b]*Sources*: see Appendix Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if China is excluded, there is no unemployment effect; other results are unchanged.
[c]*Sources*: see Appendix Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: excluding India makes no difference to the results.
[d]*Sources*: see Appendix Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if Russia is excluded, there is no inequality or unemployment effect; there continues to be a negative relationship with HDI.
[e]*Sources*: see Appendix Table 6.6(a). Significant at the 10 % level (*), 5 % level (**), 1 % level (***). *Summary*: if South Africa is excluded, there is no unemployment effect; other results are unchanged.

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Chapter 7
Access to Justice in India

Neela Badami and Malavika Chandu

> The judicial system, on the whole, is tolerably adequate [. . .]Despite all achievements, a few serious defects [. . .] have become time-honoured as they have persisted for so long.
> –M.P Jain, Outlines of Indian Legal and Constitutional History

7.1 Introduction

The present law of civil procedure in India is found in the Code of Civil Procedure, 1908 (CPC) as amended from time to time and supplemented by the rules of the High Courts of the various states of the federation. As is obvious from the date of the CPC, it is a piece of pre-Independence legislation that has survived ever since India's independence in 1947. This chapter will first briefly survey the evolution of India's system of civil justice from a historical perspective (Sect. 7.2). It will then join the effort of other chapters of this book on access to justice in various countries and regions of the world to analyse rules and structures of civil procedure in India (Sect. 7.3). In doing so we follow the general outline of the questionnaire designed at the University of Louvain ("Louvain Questionnaire") for the purpose of developing indicators of access to justice in terms of cost and time factors (Schmiegelow and Schmiegelow 2012). We believe, however, that at least some of the features of India's case warrant distinguishing three time horizons, i.e. pre-colonial, colonial and post-independence, as well as two levels of analysis, i.e. legislative intent and de facto conditions.

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7.2 History of Procedural Law in India

India has a known history of around 5000 years. Condensing M.P. Jain's Outline of Indian Legal and Constitutional History (2012), we can roughly divide it in the three periods just mentioned. Prior to the British period, there were the Hindu and Muslim periods, with each having its own distinct legal system (Jain 2012; Rama Jois 2010). Even during British rule, Hindu and Muslim laws were applied to Hindus and Muslims respectively, to deal with issues of inheritance and succession and this was given effect through the recognition of caste-based rules (Bannerjee 2008, p. 51, para 20). This was removed only by the Government of India Act of 1935 (Keith 1990, p. 89). Except for major reform legislations after independence such as in the area of labour law, India's present day legal system is one which was created by the British, and constitutes a fundamental break from the past (Bannerjee 2008, p. 51, para 20). Hence, it is a useful starting point, although it cuts across the pre-Independence and post-Independence line.

7.2.1 The Colonial Transplant of English Law to India

The administrative responsibility of the British began first with the three 'Presidency Towns' of Bombay (Mumbai), Madras (Chennai) and Calcutta (Kolkata). An elementary judicial system with non-lawyer judges and large amounts of executive discretion ruled the day for nearly 150 years, with the establishment of a 'Supreme Court' at Calcutta in 1774. Simultaneously, in 1772, the East India Company began to administer the vast Bengal province, and established a judicial system ('*adalat*') together with an administrative and revenue system. It was only in 1793, however, that the revenue collection and judicial functions were separated (Bannerjee 2008, pp. 191–194). Starting off as primitive courts manned by civil servants untrained in law, they evolved to meet the demands of the people, through the appointment of Indian judges by 1831 (Bannerjee 2008, p. 196). This *adalat* system was introduced in other territories as and when acquired (Bannerjee 2008, pp. 24–25, 195).

It is important to note that two parallel systems were developing. The courts in the Presidency Towns catered primarily to the needs of the Englishmen living there, and were replicas of the English judicial system. In the areas outside the Presidency Towns, or the '*mofussil*,' where the population was predominantly rural and Indian, a simple *adalat* system that administered Hindu and Muslim personal laws held sway (Jain 2012).

In 1862, these two systems were unified through the establishment of the High Courts. These High Courts were the precursors of India's present day legal system (Jain 2012) A peculiar feature of legal development in India is that for a long time the administrators "*endeavoured to create a system of courts without ever attempting to create a body of law*" (Jain 2012, p. 4). It was only from 1833 onwards, under the influence of Jeremy Bentham's doctrine of legislation, that

courts were replaced by the legislature as the maker of law. English law in a simplified form was accepted as the basis of the new codes, and became universal across the Presidency Towns and the *mofussils*.

7.2.2 The Enactment of the Code of Civil Procedure

In this background, the first consolidated Code of Civil Procedure was enacted in 1859. Prior to this, each of the different provinces in India had their own code with some authors going so far as to say that '*before the passage of* [*the CPC*], *the law of civil procedure was almost chaotic*' (Jain 2012, p. 482). The new code was however, far from perfect. The strongest critic of this code, Dr. Whitley Stokes, the then Secretary to the Government of India, redrafted the code, and rearranged the provisions drastically. His draft, when enacted in 1877, incorporated provisions based on orders made in England under the Judicature Acts, which set up high courts all over the country, as well as provisions from the New York Code. This 1877 Code was amended in 1898, which was further amended to make it less rigid. This final amendment led to the adoption of the 1908 Code, which is currently still in force, subject to some amendments over the years (Law Commission of India (LCI) 1964, para 2–6).

It is worth taking a small detour into the world of anecdotal evidence to get a flavour of the procedural "walk" in the early part of the twentieth century in British India. Jim Corbett, the celebrated British hunter-turned-wildlife-conservationist who has written prolifically about his adventures hunting man-eating tigers in India in the days of the British Raj, has also captured vignettes of British colonial life in the early 1900s. In one such story, entitled 'Pre-Red-Tape Days,' he writes about a camping trip in the Himalayan foothills with one Sir Frederick Anderson, at the time the Superintendent of the Terai and Bhabar Government Estates. Corbett compares Sir Frederick to General Sir Henry Ramsay, the 'Uncrowned King of Kumaon,' who, '*in addition to being Judge of Kumaon, was also magistrate, policeman, forest officer and engineer, and as his duties were manifold and onerous he performed many of them while walking from one camp to another. It was his custom while on these long walks, and while accompanied by a crowd of people, to try all his civil and criminal cases. The complainant and his witnesses were first heard, and then the defendant and his witnesses, and after due deliberation, Ramsay would pronounce judgment, which might either be a fine, or a sentence to imprisonment. In no case was his judgment known to be questioned, nor did any man whom he had sentenced to a fine or imprisonment fail to pay the fine into the government treasury or fail to report himself to the nearest jail to carry out the term of simple or rigorous imprisonment to which Ramsay had sentenced him*' (Corbett 1952).

Coming down south, the eminent Indian sociologist M.N Srinivas, has captured beautifully the average Indian's general attitude towards the law courts in the middle of the twentieth century in his book, *The Remembered Village* (1976). In

the years immediately following Indian Independence (1947), traditional dispute settlement in Indian villages in South India was very much prevalent, and as described by Srinivas, consisted largely of the village headman or other leading village personality (based generally on status, derived mainly through land ownership) settling disputes brought to him by the villagers. These disputes ranged from property-related, to theft, to matrimonial matters. In this historical period, law courts established in urban centres were viewed sceptically by the villagers, who '*did not understand the law or justice which was dispensed in them. The legal system appeared to many as a complicated and half-understood game which litigants played by hiring lawyers who were supposed to know the rules*' (Srinivas 1976, p. 114).

The above examples are not to suggest that dispute settlement at the local level (whether British or Indian) outside of the law courts was some form of idyllic, ideal system of justice (in fact, Srinivas himself notes that '*the corruptibility of arbitrators was a perennial theme of village life, and one of its functions, apart from any element of truth which it may have had, was to enable the defeated disputant to accept an unfavourable decision*' (Srinivas 1976, p. 315). Rather, it is to provide a flavour of the multiplicity of procedural methods that have held sway in different time periods; as well as the long lineage of ADR methods in India (discussed further at 7.3.2 below).

Initially, the jury system as well was part of the colonial transplant. First implemented in Bengal, it spread to the rest of the country through the Code of Criminal Procedure enacted in 1882. The jury system which existed under the rule of the East India Company merely served as a rubber-stamping mechanism, however, which approved of the decision suggested to it by the judge in charge of the trial. In addition, the juries themselves were skewed to benefit the British, with a majority of the jurypersons being of the same race as the accused (Vogler 2001; Ramnath 2013).

The Law Commission in its 14th Report (1958, pp. 864–873) conducted an extensive survey on the perception of jury trials in India and found that the public was largely in favour of abolishing the system. By that time, this system existed only for criminal trials [it was abolished in civil cases as early as 1836 (Ramnath 2013)], and in limited territorial jurisdictions. Of the several reasons put forth, it was suggested that juries were susceptible to influence and took into consideration external elements in order to reach their conclusion. This, along with the nature of appeals, and the absence of any perceptible benefit accruing towards the correctness of the verdict rendered by a jury, led the Commission to the conclusion that the jury system was a colonial transplant which was not successful in India, and therefore recommended its abolition.

The last trial conducted resulting a verdict delivered by a jury was that of *K.N. Nanavati v. State of Maharashtra* (AIR 1962 SC 605) a case which attracted tremendous media attention, since it involved a naval officer who killed his wife's paramour. The jury acquitted him, a verdict which was later reversed by the High Court and upheld by the Supreme Court. Judicial sentiment against juries was solidified after this verdict, since the jury acquitted him seemingly because his

actions were morally justifiable, and since the defendant was an appealing public figure, with whom the public could relate. On the facts, however, his actions fulfilled all the requirements for the crime of murder under the Indian Penal Code, 1860. At the time when this Report was submitted, criminal procedure was covered by the law of 1898, which was subsequently repealed, in an overhaul, resulting in the current law of 1973. This law does not mention trials by juries, and the concept has simply faded away to obscurity.

7.3 Rules and Structures of Civil Procedure

This section will go over some of the features of Indian civil procedure, following the structure of the Questionnaire. We will focus on the most basic rules and structures from a comparative law perspective (Sect. 7.3.1), as well as on alternative dispute resolution mechanisms (Sect. 7.3.2), status and pay of judges (Sect. 7.3.3), status and pay of lawyers (Sect. 7.3.4), cost rules and structures (Sect. 7.3.5), density of legal structures (Sect. 7.3.6), litigation density (Sect. 7.3.7) and lastly, the duration of civil law proceedings (Sect. 7.3.8).

7.3.1 Basic Rules and Structures

Civil procedure in India is based on English common law principles and the adversarial model where the plaintiff and defendant are pitted against each other in battle (Strick 1977). The Court also has the power to set up commissions of experts, for specific investigation (Section 75(e) CPC). With Order XVI Rule 1(3), CPC empowers the Court to issue summons for witnesses who are not on the witness list of either of the parties. The court may also call for experts under this question. Amicus curiae may be appointed by the Supreme Court in cases where the legal services authority is unable to find adequate representation for the accused (Supreme Court Handbook 2010).

Both written (Order VI: Pleadings Generally, Order VII: Plaint and Order VIII: Written Statement, Set Off, Counter Claim) and oral pleadings (Order X) are provided for in the Code. The Code provides the Court with the discretion to call for more pleadings (Order VI Rule 16 CPC) and written statements (Order VIII Rule 9). This, to a certain extent, encompasses the power of the Court to identify relevant facts and call for more evidence on the same.

As a rule, a party need not plead the law; instead it is for the court to examine all questions of law which may apply to the facts (*Kedarlal Seal v. Harilal Seal* 1952). Parties need not prove facts which are judicially noticeable, as detailed in Section 57 of the Indian Evidence Act, 1872. However, the list detailed in the section extends only to laws which are in the statute books and not to interpretations of the Courts. Therefore, Order XIV Rule 4 of the CPC divides issues into issues of

fact and issues of law, both of which have to be proved. Even if the parties are in agreement as to the issue of law (Order XIV, Rule 6), the Court will still be required to make a determination on the issue. Foreign law must be proved as a fact.

While the manner and pace at which proceedings are to be conducted is determined by the CPC, the pace of proceedings is admittedly very slow due to a variety of factors, including the fact that there are vastly more cases to be dealt with than judges to deal with them, the fact that some lawyers tend to ask for frequent adjournments in the proceedings, as a delaying tactic (although the Court will only grant an adjournment if sufficient cause is shown (Order XVII, Rule 1) and sometimes imposes costs, as under Order XVII Rule 2. In fact, a recent analysis of the problem of delays in the legal system suggests that lawyers control the pace of proceedings, and that judges are most often powerless to stop them (Robinson 2013). As an eminent jurist and Supreme Court advocate Fali S Nariman has noted, '*In the Indian legal system, there is ample—sometimes excessive—due process; and one has to be patient and persevering*' (Nariman 2010).

The two-tier structure of solicitors and barristers is currently existent only in the State of Maharashtra, where there is an active division, but such division is unofficial (Bombay Bar Association 2013). The exam is itself unofficially conducted by the Bombay Incorporated Law Society. The only legislatively recognized division is of advocates and senior advocates, further described in Sect. 7.3.4.

Since 1947, there has been no strict system of a class action, but the CPC has always allowed parties to be joined to proceedings when they have a legal interest (whether as the plaintiff or as the respondent), and to have all these parties represented by a single person (Order I Rule 8, CPC). The concept is known as a representative suit. In practice, however, this has not been used to institute class actions as understood in other jurisdictions such as the United States. The issue of execution of decrees in such suits was altered with an amendment in 1976 of the CPC, which currently allows for the decree to be binding on all the parties on whose behalf the suit was instituted or defended, as the case may be.

Summary debt procedures are institutionalised in the Code, Order XXXVII Rule 1 (2) (b). These provisions were enacted in 1908, under the original code, with no amendments since. It provides that the summary suit provisions apply to any suit filed by the plaintiff for recovery of a debt/money payable by the defendant according to a written contract. The object behind provision of summary procedure was to ensure a speedy trial for recovery of money in cases where the defendant has no defence and thus any unreasonable delay sought to be caused is eliminated.

If the defendant fails to appear on an appointed date, ex-parte orders can be issued by the courts if the following conditions are satisfied: ongoing loss/danger of property in question being wasted; loss cannot be compensated in monetary terms; and is irreparable. These conditions would mean that default judgments are not a routine procedure as in other common law countries such as the UK and the US as well as many civil law countries.

7.3.2 *Out-of-Court Settlements/Alternative Dispute Resolution Mechanisms (ADR)*

ADR methods are not new to India and have been in existence in some form or the other in the days before the modern justice delivery system was introduced by the colonial British rulers. Out-of-court settlement was the norm in pre-colonial India, where '*Panchayats*' or a council of village elders settled disputes that arose among the inhabitants (Rama Jois 2010).

In the colonial period, the introduction of *diwani adalats* as well as English-style courts came about, as described in Sect. 7.2. Running parallel almost since the birth of the formal civil justice system, has been the recognition that there is a need to enable alternate dispute resolution mechanisms. Therefore, even under British rule, there was an effort to popularise the *panchayat* system through various means, including the establishment of 'village courts' across the various provinces of the Indian territories (LCI 1958, pp. 874–875). Most of these legislations contained a provision to the effect that the procedure to be followed by these courts '*shall be such as it may consider just and convenient and the bench shall not be bound to follow any laws of evidence or procedure other than the procedure prescribed* [*under this legislation*]' (LCI 1958, p. 883). Legal practitioners were also barred from appearing before these courts/*panchayats* (LCI 1958, p. 884). In addition, the Privy Council had also granted its imprimatur to decisions of the *panchayat* (*Sitanna v. Marivada Viranna*), AIR 1934 PC 105, cited in LCI Report No. 222 2009b, p. 23).

In the post Independence era, there are at least three distinct spheres to examine:

7.3.2.1 To Retain or Not to Retain?

The first was the question of whether Independent India ought to retain the colonial transplant or not, which was examined in some detail by the LCI (1958). The LCI came to the conclusion that it was not possible to oust the colonial transplant and go back to pre-colonial systems, especially since India's new Constitution was itself based on an Anglo-Saxon model.

7.3.2.2 Panchayats

The second aspect relates to one existing mode of ADR—the *Panchayat* system. The LCI also looked at the working of the *Panchayat* system across the country in great detail. It also analysed various criticisms levelled against these courts (including factionalisation of villages on political and communal lines as a consequence of the multi-party election system) and came to the conclusion that the pros outweighed the cons, and the *Panchayat* system should continue to be in place as an alternative to the existing court system '*with safeguards designed to ensure their*

proper working and improvement' (LCI 1958, p. 917). It must be admitted that the working of these *panchayats* has not lived up to the high hopes originally pinned on them (Galanter 1981, p. 25). While they have been successful in some states, like Karnataka and West Bengal, in other states, these panchayats have fallen prey to the problems of caste-based politics, and poll rigging (Ghatak and Ghatak 2002; Pal 2004).

7.3.2.3 New Developments

The third sphere relates to new efforts made post-1947 to introduce new methods of ADR, each of which are discussed below.

(i) *Lok Adalats*

The Directive Principles of State Policy under Part IV of the Constitution provide policy guidelines for the State. One such provision is Article 39A, which mandates the State to secure that the operation of the legal system promotes justice on a basis of equal opportunity, and ensure that the same is not denied to any citizen by reason of economic or other disabilities. Equal opportunity must be afforded in order to have access to justice. The expression "access to justice" focuses on the following two basic purposes of the legal system:

1. The system must be equally accessible to all
2. It must lead to results that are individually and socially just

This idea of access to justice, although non justiciable, influences most legislative, and judicial thought on changes to the judicial system (LCI 2012).

Parliament enacted the Legal Services Authorities Act (1987) in view of the mandate under Article 39A of the Indian Constitution, which also constituted the *Lok Adalats*, being a statutory forum where disputants may go before litigation or to which courts may refer pending cases for counselling and conciliation. The disposal of disputes at the pre-litigation stage itself by the permanent and continuous *Lok Adalats* is aimed at providing inexpensive justice to the parties. While few studies have been done documenting the success of *Lok Adalats*, one such study provides a critical analysis of the institution of *Lok Adalats* and has examined, in depth, their success in the state of West Bengal post-1998 (Khan 2006).

The 222nd Report of the Law Commission of India (LCI Report No. 222, 2009b) noted that the traditional concept of "access to justice" is the access to courts of law. However, the courts have become inaccessible due to various barriers such as poverty, social and political backwardness, illiteracy, ignorance, procedural formalities and the like.

(ii) *Gram Nyayalayas*

The Constitution of India through Article 14 guarantees as a fundamental right, equality before law and the equal protection of the laws. The Parliament

has very recently enacted the Gram Nyayalayas Act 2008. Justice to the poor 'at their doorstep' was sought to be achieved through the setting up of *Gram Nyayalayas* which would travel from place to place to bring speedy, affordable and substantial justice to the people of rural areas. As per a press release by the Ministry of Law and Justice in 2012, there are 166 *Gram Nyayalayas* that have been notified, out of which 151 are functioning. Madhya Pradesh has operationalised 89 of the *Gram Nyayalayas*, while Rajasthan, Orissa, and Maharashtra have operationalised 45, 8 and 9 respectively (Press Information Bureau 2012).

(iii) *Amendments to the CPC*

Section 89, providing for settlement of disputes outside the Court, was inserted in the CPC in 1999 and brought into force with effect from 2002, based on the recommendations made by the LCI and the Malimath Committee. It was suggested by the LCI that the Court may require attendance of any party to the suit or proceedings to appear in person with a view to arriving at an amicable settlement of dispute. The Malimath Committee recommended that it be made obligatory for the court to refer the dispute, after issues are framed, for settlement either by way of arbitration, conciliation, mediation, judicial settlement or through *Lok Adalat*, and only when the parties fail to get their disputes settled through any of the alternate dispute resolution methods, that the suit could proceed further (Statement of Objects and Reasons). Section 89 now provides for the Court to refer the dispute after issues are framed for settlement either by way of (a) arbitration, (b) conciliation, (c) judicial settlement including settlement through *Lok Adalat*, or (d) mediation. Where the parties fail to get their disputes settled through any of the alternative dispute resolution methods, the suit could proceed further in the Court in which it was filed. The Government and the High Courts are empowered to make rules to be followed in mediation proceedings to effect the compromise between the parties. But since the section is unclear as to what stage of the proceedings the reference is to be made, it has not had a significant impact.

Perhaps predictably, an association of lawyers challenged the above amendment as a whole (*Salem Advocate Bar Association v. Union of India* (*I*) 2003), on the grounds that Parliament lacked the legislative competence to enact such a law, which was summarily struck down. However, the arguments raised against this ADR provision were in relation to the mode of its applicability: the parties requested the court to frame guidelines or rules for the application of the section. The Court accepted this suggestion, and ordered a committee to be set up, to create guidelines for the application of Section 89.

(iv) *Liberalisation-inspired efforts*

As part of its economic reforms in the early 90s, India also undertook major reforms in its arbitration law, since chronic delays in dispute settlement by the courts was seen as one of the reasons for the lack of inflow of foreign direct investment into India from abroad. The Arbitration and Conciliation Act of 1996 was thus enacted by the Parliament bringing in substantial reforms in arbitration, regarding domestic and international disputes, replacing the earlier

Act of 1940. The decision of the Supreme Court in *Konkan Railway Corpn. Ltd. v. M/s. Mehul Construction Co.* (2000) summarises the evolution of the Arbitration & Conciliation Act 1996 and the main provisions of the Act in some detail, and also dwells on the history as well as the legislative intent of the new law:

> 4. At the outset, it must be borne in mind that prior to the 1996 Act, the Arbitration Act of 1940, which was in force in India provided for domestic arbitration and no provision was there to deal with the foreign awards. So far as the Foreign Awards are concerned, the same were being dealt with by the Arbitration (Protocol and Convention) Act, 1937, and the Foreign Awards (Recognition and Enforcement) Act, 1961. The increasing growth of global trade and the delay in disposal of cases in Courts under the normal system in several countries made it imperative to have the perception of an alternative Dispute Resolution System, more particularly, in the matter of commercial disputes.
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> [. . .]A bare comparison of different provisions of the Arbitration Act of 1940 with the provisions of the Arbitration and Conciliation Act 1996 would unequivocally indicate that 1996 Act limits intervention of Court with an arbitral process to the minimum and it is certainly not the legislative intent that each and every order passed by an authority under the Act would be a subject matter of judicial scrutiny of a Court of Law.[. . .]. The Statement of Objects and Reasons of the Act clearly enunciates that the main objective of the legislation was to minimise the supervisory role of Courts in the arbitral process.

Thus, the legislative intent was to minimise the involvement of the judiciary in the ADR process. This too, has had a fair amount of twists and turns in practice. What is seen in everyday practice of commercial disputes/litigation is that the injuring party would like to delay the process of arbitration as much as possible. Effectively, it is in its/his interest not to participate whole-heartedly in the arbitration proceedings. Parties can still activate the jurisdiction of the civil courts under Section 9 (interim relief), Section 11 (appointment of arbitrators) or Section 34 (challenging the enforcement of the arbitration award). While the ADR procedure was intended to be an independent alternative to the judiciary, the Indian courts, loath to cede power away completely, have constantly brought arbitration procedure back under the supervision of the Court, in a line of cases culminating in *SBP* v. *Patel Engineering* (2005).

Until very recently, further confusion was caused because Indian courts had been holding that these sections were applicable even in the case of international commercial arbitrations, completely deviating from the legislative intent of speeding up resolution of international commercial disputes. In a welcome move, however, the decision of the Supreme Court in *BALCO* (2012) has overturned the troublesome precedents, bringing symmetry between international law/practice and the intent of the Arbitration and Conciliation Act, 1996. Now, in the context of international commercial arbitrations, the Indian Courts cannot be activated under Sections 9, 11 or 34.

7.3.3 The Status and Pay of Judges

In the pre-colonial period, the *panchayats* were staffed by village elders. In the colonial period, as discussed in the first section, the courts established by the British often had judges with no judicial training or even a law background. This changed and evolved over time.

Now, in the post-independence era, the subordinate judiciary, all consist of professional or career judges. With respect to the higher judiciary, qualifications of judges of the high courts and the Supreme Court as prescribed by the Constitution of 1949, in effect since 1950. High Court judges must be Indian citizens and must have held judicial office in the territory of India for at least 10 years; or must have been an advocate of a High Court(s) for at least 10 years. A Supreme Court judge must be an Indian citizen and must have been a High Court judge for at least 5 years, or at least for 10 years been an advocate of a High Court(s); or is, in the opinion of the President, a distinguished jurist. The intention of this provision is to take from the US example, and to allow eminent non-practicing lawyers, that is, academicians, to be appointed as judges of the Supreme Court (Constitution Assembly Debates 1989, p. 254).

The criterion of 'distinguished jurist' was also present for the High Court judges, but was removed in 1976 through an amendment of the Constitution. In practice, even in the higher judiciary, it is rarely that a person gets elevated without being a career judge. One striking exception was Justice Santosh Hegde who was elevated to a judgeship of the Supreme Court. Prior to his elevation, he had served as Solicitor-General of India, the chief lawyer of the state appearing before the Supreme Court.

At the subordinate judiciary level, judges are selected through an examination conducted by each state separately, after obtaining a law degree. Candidates are not required to have practical work experience.

Qualifications (academic/practical training) vary from state to state. For example in Maharashtra (large state on the Western seaboard, home to Mumbai/Bombay, financial capital of the country), the qualifications for civil judges are of two kinds: they may either be fresh law graduates, or advocates with at least 10 years of experience. Thus there is no requirement for both practical and academic training. This is of course at the lowest level; to be promoted, the judge must have a minimum period of experience at the lower level. Similarly, to be eligible to appear for the examination in the capital city of New Delhi, a person must be enrolled as an advocate, or should be eligible to be enrolled as an advocate (Point 1-2, Rule 5, Table C, Maharashtra Judicial Services Rules 2008, Rule 5, Table C, Maharashtra Judicial Services Rules 2008, Rule 14(b), Delhi Judicial Services Rules 1970).

Through recent amendments to each state's judicial service rules, most states have equalised the pay of civil judges. Almost all major states follow this scale (The Hindu 2010; The Indian Express 2011). A Junior Civil Judge receives, per mensem, basic pay between Rs. 27,700 and 44,770 (approx. $515–830), with increments along the year. A Senior Civil Judge receives basic pay between Rs. 39,530 and

54,010 (approx. $730–1,000). For the judges who are one designation higher, the entry-level District Judge is paid a basic salary between Rs. 51,550 and 63,070 (approx. $955–1,170), while Selection Grade District Judge, a designation reached after 2 years of service, receives basic pay between Rs. 57,700 and 70,290 (approx. $1,070–1,300). Finally, the pay for Super Time Scale District Judge (the designation accorded after 5 years of service as a district judge) ranges between Rs. 70,290 and 76,450 ($1,300–1,420).

Civil servants at the junior scale receive basic pay of between Rs. 15,600 and 39,100 (approx. $295–740), with increments at Rs. 5,400 (approx $100); Senior time scale receive the same pay as junior scale personnel, but with increments at Rs. 6,600 (approx. $125). At the selection grade scale, Indian Administrative Service (IAS) officers receive between Rs. 37,400 and 67,000 (approx $705–1,265), with increments of Rs. 8,700 (approx. $165). The super time scale attracts the same basic pay, but increments are Rs. 10,000 (approx. $190) (Rule 3, Indian Administrative Service (Pay) Rules 2007).

Indian Administrative Service (IAS) officers are appointed by the Union Public Service Commission (UPSC), and are therefore paid by the Union Government, but the subordinate judiciary is appointed, and paid by the respective state governments. However, to be given district-level postings in the IAS is an entry level post, while the same post, when allotted under the state cadre, when entry is through the respective State Public Service Commissions, is a high level posting, and so, in terms of experience, it seems more prudent to compare subordinate judges' pay with the IAS cadre, rather than with the state administrative service cadre.

At the High Court level, the Chief Justice receives Rs. 90,000 per mensem (approx $1,700) while his/her companion judges receive Rs. 80,000 per mensem (approx. $1,510) (Section 13A (1)–(2), The High Court Judges (Salaries and Conditions of Service) Act 1954). Other perquisites such as housing, transportation, staff, are separately provided. At the Supreme Court level, the Chief Justice receives Rs. 100,000 per mensem (approx. $1,890) while his/her companion judges receive Rs. 90,000 per mensem (Section 12A(1)–(2) The Supreme Court Judges (Salaries And Conditions Of Service) Act 1958). Housing, transportation and staff are separately provided.

The basic pay for both civil servants and the higher judiciary is the same. At the state level, the comparable civil service positions are principal secretaries, and the chief secretary to the government of the state, both of whom are officers under the IAS. Principal Secretaries are paid Rs. 67,000, with 3 % annual increments, up to a maximum of Rs. 79,000 (approx $1,490), while the chief secretary is paid a fixed sum of Rs. 80,000 (Schedule II, Indian Administrative Service (Pay) Rules 2007). A cabinet secretary to the Government of India is paid a fixed basic salary of Rs. 90,000.

While members of the higher judiciary enjoy a certain standing in society, the levels of compensation (compared to the earnings of an advocate in private practice) deter many a senior advocate from taking up judicial office. Retired judges often preside over arbitral proceedings and are the prime candidate for appointment

as arbitrators chosen under Section 11 of the Arbitration Act, and are also called upon to serve on Commissions of Inquiry set up by the government.

7.3.4 Status and Pay of Lawyers

7.3.4.1 Legal Profession as a Business

(i) *Pre-Colonial Period*

It is a matter for debate among historians as to whether legal practioners existed in India before the British set up their legal system in India. Despite the lack of definitive answers to this question, it is clear that practioners of the adversarial system did not exist before British rule (LCI Report No. 131 1988c, para 1.4).

(ii) *Colonial Period*

Through the Royal Charter of 1774 which established the Calcutta Supreme Court (and was later extended to other Presidency Towns to establish Supreme Courts there) courts could approve, admit and enroll advocates and attorneys to plead and act on behalf of the suitors. They could also remove lawyers from their rolls on 'reasonable cause and to prohibit practitioners not properly admitted and enrolled and from practicing in the court.' This is the first time this power was granted to the courts, prior to this, the power to admit attorneys was vested with the Governor-General (Bar Council of India ("BCI") 2013a, History of the Legal Profession). Originally, these persons were barristers and solicitors who were enrolled in England. Native pleaders called *vakils* were allowed to be appointed after the Bengal Regulation of 1793, but it was several decades before they gained enough importance to be able to practice at the Presidency Towns. Initially, the Presidency Courts applied British law, while the *Mofussil* Courts applied Hindu and Muslim law, which strengthened the hierarchy of practice: native *vakils* only practiced at the *moufissil*, while the British practiced, with a near monopoly, in the Presidencies.

The stronghold of Presidency Towns began to dilute with the establishment of High Courts across the country, which began in 1862. This establishment also saw the consolidation of the grades of legal practice in India, under the supervision of the High Courts, with the Legal Practitioners Act of 1879. There were six categories of legal practitioners which categorisation has now been abolished with the enactment of the Advocates Act, 1961. Now, law graduates can only enrol as advocates, and not in any other category. (The old six categories were of advocates, attorneys (solicitors), vakils of High Courts, pleaders, mukhtars and revenue agents. Pleaders are still present, and they are given special permission to practice, under either the CPC or the Code of Criminal Procedure 1973.)

(iii) *Post-Independence*

The present Advocates Act was enacted in 1961, which repealed the central Legal Practitioners Act, and state legislation which created categories of advocates (Section 50, Advocates Act, 1961). Since this enactment, there has only been the categorisation of advocate and senior advocate, where a senior advocate only pleads before the court, and does not accept briefs, or interact with clients directly.

Currently, there are 1.2 million advocates enrolled in the various state bar associations, as of 2011, for a population of around 1.21 billion, and the profession has a share of $1,109,850 out of a total GDP of $1.85 Trillion (about 0.5 %) (BCI Vision Statement 2013b; Ganz 2013). The judiciary has on occasion commented on what the profession is, or should aspire to be, for example, Justice Krishna Iyer, has said that "*Law is not a trade*, *not briefs*, *not merchandise*, *and so the heaven of commercial competition should not vulgarise the legal profession*" (*Bar Council of India v. M V Dhabokar* 1976, para 25).

Increasingly, however, courts have recognised 'legal service' as a 'service' rendered to consumers, and have held that lawyers are accountable to clients if there is a 'deficiency' in such services. For example, in the case of *Srimathi* v. *Union of India* (1996), the Madras High Court held that, in view of Section 3 of Consumer Protection Act (1986), consumer protection forums have jurisdiction to deal with claims against advocates. It should be mentioned that legal services remain a domain open only to advocates with law degrees recognised by the Bar Council of India, and not foreign lawyers.

7.3.4.2 Academic and Practical Training

Section 24 of the Advocates Act (1961) states that a person seeking enrolment must have a law degree from any university in India. Practical experience is not required as per the Advocates Act, but the Bar Council Rules of Legal Education have a section on internships: at least 4 weeks per academic year is required to be spent on for internships (BCI Rules on Legal Education 2008).

The Supreme Court had noted in 2009 'the low standards of legal education' and constituted a three-member committee consisting of the then Chairman of the Bar Council of India, a former Chairman of the Bar Council of India, and a former President of the Supreme Court Bar Association, to address the issue of affiliation of colleges. The Committee recommended the introduction of a bar examination for the purpose of admitting law graduates to the bar as well as the formation of the National Legal Knowledge Council to oversee future reform on legal education (Committee Report on Legal Education 2009). The Bar Council of India ("BCI") framed rules to conduct the All India Bar Exam ("AIBE"). The AIBE has a stated objective to:

- Assess an advocate's ability to practice the profession of law
- Assess the legal capabilities at a basic level
- Set a minimum standard for admission to the practice of law

- Assess an advocate's analytical abilities and basic knowledge of law (BCI Letter 2010)

From its inception, however, the AIBE has been mired in controversy, with legal challenges to its validity, groups of advocates going on strike, and long delays between one exam date and the next. Nevertheless, despite all these initial hiccups, the AIBE is a step in the right direction towards ensuring an improvement in the quality of lawyers. The setting up of the 'National Law Schools' is another example of the ongoing process in India to improve the quality of the Indian bar (Jain 2012).

7.3.4.3 Lawyers' Fees

In practice, the market determines the fees payable to lawyers. Rules framed by the High Courts of various states contain schedules of fees payable to attorneys that the court may award while making its order as to costs. These rates are somewhat realistic in some states such as Maharashtra and Delhi, and woefully inadequate in others, such as Karnataka. It must be noted that in reality, competent counsel can, and do, charge very hefty fees that nowhere resemble those prescribed in these schedules (Badami 2012).

India's judicial system does not allow success fees/contingency fees (Badami 2012). The Bar Council of India's Standards of Professional Conduct and Etiquette ("BCI Rules") prescribes an advocate's duty to his/her clients, and prohibits the stipulation of fees contingent on the results of litigation; or any agreement to share the proceeds of litigation. Advocates cannot buy/traffic in/stipulate for/agree to receive any share or interest in any actionable claim. His/her duty to his/her colleagues includes not accepting a fee less than the fee taxable under the rules when the client is able to pay the same. Neither are advocates allowed to sell claims for purposes of litigation (i.e., plaintiffs cannot subrogate their claim to an attorney, a law firm, or an entrepreneur who finances the litigation) as the BCI Rules prohibits advocates from acting or pleading in any matter in which he/she himself/herself is pecuniarily interested. Neither is subrogation to an entrepreneur possible since champerty is prohibited. However, devices like assignment of contract, sale of business, sale of land, etc. are sometimes used. The Court will examine whether these arrangements were executed in good faith.

7.3.5 Cost Rules and Structures

Condensing Neela Badami's 'Shifting Sands and Pyrrhic Victories' (2011), we can summarize India's cost rules and structure as follows. Court fees have always been a controversial subject in India. In the period before colonisation, the concept of court fees was unknown. Court fees were first levied in the Presidency Towns in the 18th century. The Bengal Regulation of 1793, in particular, recorded in its preamble

that the imposition of court fees was justifiable in that it would discourage frivolous litigation. It is interesting to note that Lord Macaulay (the first Law Member in the British Governor-General's Council) considered this statement indefensible and described it as the '*most eminently absurd preamble that was ever drawn*'(LCI Report No. 128 1988b). Court fees are levied on the value of the subject matter in dispute, and are thus called '*ad valorem*' fees. The fees levied are a specific amount corresponding to the value of the suit, as laid down in the Court Fees Act (1870).

India has since had a long line of legislative and judicial thought behind the principle that access to justice should not be hindered by an excessive levy of court fees, keeping in mind constitutional dictates as well as the principle that it is the duty of the state to provide a system of justice administration whose costs should be met out of general appropriations (taxpayer funding) and not through the levy of court fees alone. Since any analysis of cost and fee allocation is intrinsically tied in with the structure of the Indian judiciary, it is worth taking a quick moment to understand the hierarchy of the Indian courts. India has a quasi-federal structure with 29 States further sub-divided into about 601 administrative Districts. The Judicial system however has a unified structure, with the Supreme Court, the High Courts and the lower Courts comprising a single Judiciary. Each District has a District Court, and each State, a High Court. Each State has its own laws constituting Courts subordinate to the District Courts.

Any discussion of cost needs to keep in mind that there are a plethora of different rules operating in India—the pre-Independence and pre-Constitution central 'Suits Valuation Act, 1870' remains in force even though several states have opted out of its application, exercising their constitutional competence to enact their own rules for valuation of suits. Court fees may therefore be governed by the Suits Valuation Act of 1870, or specific enactments in force in particular states, or a combination thereof, which would occur in the event that a state has chosen to effect amendments to the central act, and then apply it to itself.

The fact that states have discretion in fixing court fees has led the Supreme Court of India to observe that there are vast differences in the scales of court fees charged in the different states of the country (in some cases it can be as high as 10 % of the value of the suit) and has called for standardising them (*Secretary to Government of Madras v. P. R. Sriramulu* 1996) The Law Commission submitted its 220th Report in 2009, recommending that the Government fix the maximum fees that may be charged in subordinate courts (LCI Report No. 220 2009a). The Government has not yet taken steps to do so.

Under the CPC, and subject to such conditions and limitations as may be prescribed, 'the costs of and incident to all suits shall be in the discretion of the Court, and the Court shall have full power to determine by whom or out of what property and to what extent such costs are to be paid, and to give all necessary directions for the purposes aforesaid' (Section 35). Importantly, the Code also mandates that 'Where the Court directs that any costs shall not follow the event, the Court shall state its reasons in writing' (Section 35(2)) The expression 'costs [to] follow the event' indicates that the Code presumes cost-shifting from the winner to the loser, and expects that this rule be followed except where the court

feels that there are reasons not to so shift. This means that the successful party is entitled to costs unless he is guilty of misconduct or there is some other good reason for not awarding costs to him. The awarding of costs is discretionary, and the Court is free to decide what these costs may be applied to: whether it is all of the other party's costs, or only a part.

The provisions of the Code set out above are honoured more in the breach than in the observance. Courts do not cost-shift routinely, leading the Supreme Court to observe in one case that '*many unscrupulous parties take advantage of the fact that either the costs are not awarded or nominal costs are awarded on the unsuccessful party*. ***Unfortunately, it has become a practice to direct parties to bear their own costs, despite the language of S. 35(2) of the Code***. *Such a practice also encourages the filing of frivolous suits or taking up of frivolous defences*. ***Further wherever costs are awarded, ordinarily the same are not realistic and are nominal.*** *Section 35(2) provides for costs to follow the event. It is implicit that the costs have to be those which are reasonably incurred by a successful party except in those cases where the court in its discretion may direct otherwise by recording reasons thereof*. ***The costs have to be actual reasonable costs, including the cost of the time spent by the successful party, the transportation and lodging if any, or any other incidental cost beside the payment of the court fee, lawyers fee typing and other costs in relation to the litigation. It is for the High Courts to examine these aspects*** *and wherever necessary, make requisite rules, regulations or practice direction so as to provide appropriate guidelines for the subordinate courts to follow*' (*Salem Advocate Bar Association v. Union of India* (*II*), AIR 2005 SC 3353, quoted in Mulla (2007, p. 614, emphasis added)

This observation of the Supreme Court led to the 240th Report of the Law Commission, on Costs in Civil Litigation. The Court's observation that the practice is to direct parties to bear their own costs, which are minimal, and do not serve any real purpose was adopted as a recommendation to Parliament by the Law Commission. However, it was also stressed that such costs should not obstruct access to justice; the award of costs should always keep in mind the socio-economic conditions of the parties concerned (LCI 2012, para 4.2(h)–(i) referring to *Sanjeev Kumar Jain v. Raghubir Saran Charitable Trust*, JT 2011 (12) SC 435 para 13(1)–(2)).

The Commission made one other recommendation for amendments to the Code, which has not been given effect by Parliament: a recommendation for costs to necessarily be applied when the claim is vexatious or false. Currently costs under Section 35A can only be awarded when the other party raises a claim; this amendment will allow costs to be imposed *suo motu*, in the interests of further empowering the judiciary (LCI 2012, para 8.19, Amended Section 35A (1B), para 8.17).

7.3.6 Legal Aid

The Indian Constitution mandates that the State 'secure that the operation of the legal system promotes justice on a basis of equal opportunity, and shall in particular provide free legal aid, by suitable legislation or schemes or in any other way, to ensure that opportunities for securing justice are not denied to any citizen by reason of economic or other disability' (Badami 2012). Accordingly, India has enacted the Legal Services Authorities Act (1987), brought into force in 1995, and constituted the National Legal Services Authority as well as State Legal Services Authorities.

The mode of providing legal aid varies from state to state, as well as from one practice area to the next. In Karnataka, legal aid is delivered, inter alia, to the following categories of persons: members of a scheduled caste or tribe, women, children, trafficked persons, victims of natural or industrial disasters, ethnic violence, caste atrocities, and any person whose income is below Rupees 50,000 per annum (a little over $1,000). The legal aid system is funded by the government, and administered by the relevant High Court of each state. There is however a general dearth of good, competent lawyers in the legal aid system, since it is not as lucrative as private practice.

7.3.7 Density of Legal Structures

There is no official figure available for the number of civil courts of the first instance which have been established in the country: but the practice is to have one civil court for each district; there are 640 districts after the 2011 census (Census of India 2011). The figures for the number of judges in the subordinate judiciary have been better documented. In 1987, the figure was 10.5 judges per million (LCI 1987, para 8), in 2001, this was about 12 or 13 (LCI Report No. 229, 2009c, para 2.5). The World Bank places the figure at around 2.7 for 100,000 but this takes into account allotted strength, and does not discount vacancies (Judicial Impact Assessment 2008, vol. 2, p. 1).

As of 2010, 18 % of subordinate courts seats were vacant (PRS Legislative Research 2011). As of March 2012, the subordinate judiciary (both civil and criminal, since separate figures are not available), has a sanctioned strength of 17,866, against which only 14,134 seats are filled (Supreme Court News 2012, p. 5). Although this figure, taken for the entire country does not seem excessive, some large states have almost 50 % of their sanctioned strength vacant, such as Gujarat, with vacancies of 852, against a sanctioned strength of 1,727. The smaller states and union territories have almost all their seats filled, with only a few exceptions. However, a glaring exception is Meghalaya (a hilly state in the North Eastern part of the country), which also has more than 50 % of its seats empty, 22 vacancies against a sanctioned strength of 34.

The first stage of appeal is the High Court of each state. Provisions for both the High Courts and the Supreme Court have been made in the Constitution, therefore they are constitutional courts and are considered the higher judiciary. All matters cannot be appealed from the High Courts to the Supreme Court: the methods of appeal for civil cases are two: (1) with a certificate of leave from the High Court delivering the decision to allow appeal to the Supreme Court, as it involves either an interpretation of the Constitution, or a substantial question of law of general importance; or (2) as a matter given special leave to appeal by the Supreme Court itself (Article 134A read with Article 132 & 133 and Article 136, Constitution of India).

Largely, one High Court is established for each state: currently there are 24 High Courts to cover the entire country (Venkatesan 2013). As of April 1, 2013, 292 seats are vacant in the High Courts, as against the sanctioned strength of 906, which is 32.2 % of the sanctioned strength (Department of Justice, Ministry of Law and Parliamentary Affairs 2013). The vacancies in these courts are troubling when one also examines the high number of pending matters at each of these courts, which is discussed subsequently.

During the later stages of British Rule, the highest court in the land was the Federal Court established in 1937 (Supreme Court of India 2011a, b). The Federal Court was subordinate to the Privy Council similar to all other courts in India since 1772; appeals to the Privy Council were in the same manner as from all colonies of the British Empire (Bannerjee 2008, p. 34, para 28). The Supreme Court, as it currently exists, came into existence in 1950 after its transition from the Federal Court. The sanctioned strength has constantly been increasing: it is currently at 31, with a single bench at New Delhi. The Supreme Court currently only has a filled strength of 29 (Supreme Court of India 2011a, b). There have been several recommendations to have benches in other parts of the country to improve accessibility, but these have never been adopted by Parliament (LCI Report No. 229 2009c).

7.3.8 Litigation Density, Clearance Rates and Case Backlog

The most recent complete survey on the judicial system, as a whole, including pendency, done by a government source comes from a Judicial Impact Assessment Committee set up in 2007 on the order of the Supreme Court in *Salem Advocates Bar Association (II) v. Union of India* (2005) and delivered its report in 2008. These figures are, however, not broken down into contract, summary debt or other civil law causes of action.

In 2006, the courts of first instance were largely able to dispose of 4,013,165 cases (331.51 cases per 100,000), a number marginally lesser than the number of cases freshly instituted, which was 4,019,383 (332 cases per 100,000). The underlying problem was however, that they were unable to make any inroads into clearing their backlog, which stood at 77,237,496 (598 pending cases per 100,000) pending at the end of the year (Judicial Impact Assessment 2008).

There are no provisions in Indian law, either in the Constitution or in the CPC, which requires proceedings to be completed in a time-bound manner, or within a specified period after commencement of proceedings. However, some measures to counter excessive delays and adjournments have been taken, both by amendments to the CPC by Parliament, and through judicial pronouncements by the Supreme Court. Filing of written statements (Order 8 Rule 1) has often been delayed for up to a year, on grounds of illness, pilgrimages and other flimsy reasons. However, the Supreme Court has attempted to put an end to this practice by ordering that extensions cannot be granted for more than 90 days, unless the circumstances are exceptional. (*Rani Kusum v. Kanchan Devi* 2005; *R.N. Jadi and Brothers v. Subhashchandra* 2007). The Karnataka High Court has also suggested that legislative intent also supports speedy trials, after the 1999 Amendment to the CPC, which introduced restrictions on the grant of adjournments. The law now requires that reasons must be given for granting adjournments, as well as the imposition of costs when an adjournment is granted, since ordinarily the proceedings are supposed to continue daily until all witnesses are examined (Order 17 Rule 1 & 2; *M. Mahalingam v. Shashikala* 2008).

The recently passed Companies Bill also has a provision to restrict the time taken for disposal of cases: the National Company Law Tribunal and the Appellate Tribunal are both required to dispose of matters within 3 months of the date of its presentation before it (Clause 422, Companies Bill 2012). This is a reduction in the time from the present Companies Act, which is 6 months, suggesting that Parliament is aware of the problem of increasing pendency and is attempting to curb it. Other than this, individual High Courts have also taken steps to classify cases based on when they were filed, and thereby attempting to prioritise older cases, but its success, or the lack thereof, is clearly reflected in the ever increasing rate of pendency.

At the first appellate level, the High Courts', however, the figures are equally problematic. In 2006, with the number of fresh filings at 1,082,667 (89 cases per 100,000), but disposals only at 979,275 (81 cases per 100,000), the backlog is only bound to increase with every passing year. The number of disposals seems almost insignificant against 2,968,662 pending cases across all High Courts in the same time frame (245 pending cases per 100,000) (Judicial Impact Assessment 2008).

At the Supreme Court, matters are divided into admission matters and regular matters, and no data exists for breaking down these figures into criminal and civil matters separately. However, in 2002 total institutions of admission and regular matters were 44,052 (3.63 cases per 100,000), while disposals were much fewer at 42,439 (3.5 cases per 100,000). Pendency was thus at 24,335 (2 cases per 100,000) which was a steady increase from the years before, and has continued to increase since. In 2010, this figure was found to have increased again, to 55,000 (4.54 cases per 100,000). This led to the previous Chief Justice of India, Justice S.H. Kapadia aggressively attacking this backlog (Venkatesan 2012), which was successful in the first half of 2011, but failed in the second, leading to the number of pending cases to reach 61,876 (5.11 cases per 100,000), which is up 13.4 % from the figures of the

6 months previously (Ganz 2012). Institutions in 2011 were 77,090 and disposals were 73,133 (6.63 and 6.04 respectively per 100,000).

At the end of the first half of 2012 (June 2012), fresh institutions were 15,187 as against 11,152 disposals (1.25 and 0.92 cases respectively per 100,000). The pendency for the same time period is 63,851 which are the most recent figures available.

The threat that these figures pose is in their stubborn resistance to any fall. One suggestion to combat this has been in reducing the all-pervasive problem of vacancies in the sanctioned strength at each of these courts. The figures mentioned above for the number of judges at each of these levels highlights this problem, since several courts have several vacancies, which, ideally, should be filled before any additional sanctioned strength would help clear the vast backlog. There are no figures released regarding the duration of each of these proceedings, therefore it is difficult to determine how long these matters have been pending for.

7.4 Conclusion

The CPC was a product of its times, and was prepared by the British primarily to integrate the wildly different dispute settlement procedures across the various administrative territories under their rule (including Presidency Towns and *mofussils*). To that extent, the legislative intent was clearly towards doing away with some of the 'chaos' and 'deplorable conditions' that persisted in the nineteenth century. The fundamental problems of access to justice remain in several ways, as discussed below.

The adversarial model itself is one that evolved in medieval England, as a literal pitting of might, 'may the strongest win,' model with its roots in trial by ordeal (Strick 1977). While the CPC embodying the adversarial model was clearly intended to provide clarity in what the procedure should be, whether this procedure is something that is ideal for Indian conditions is something that has given scholars, legislators, statesmen and other stakeholders sleepless nights for years. The reluctant consensus reached soon after Independence was that 200 years of water had flowed under the CPC bridge, and it was too late to revert to indigenous systems especially since Independent India's Constitution itself was based on an Anglo-Saxon model (LCI 1958).

Therefore, there are two layers of legislative intent—one, of the British, and two, of the Indian statesmen and lawmakers in their decision to continue with the transplanted system. Against this background, what are the *de facto* access to justice barriers? Primarily, India's poverty and illiteracy, the fact that 70 % of her population lives in rural villages far away from the law courts, the choice of English as the language of the higher courts (a language not spoken by the vast majority), the fact that pursuing a suit requires one to be able to read and write and engage a pleader (although provision exists for parties-in-person to represent themselves, it is

rarely used), far fewer judges than required and low pay scales resulting in corruption across the board.

Practically speaking therefore, activating the courts as a dispute settlement remedy is (1) only used as the last resort, (2) sometimes used to file frivolous cases to harass the counterparty. Even in colonial times, the majority of cases to come up before the courts related to commercial contract disputes. What we are seeing today however, is that as a consequence of time delays, all commercial contracts between major enterprises have an arbitration clause, with the venue of arbitration being London, Paris or Singapore, with either the International Chamber of Commerce's arbitration rules or the Singapore International Arbitration Centre's rules applying. As a consequence, the Indian law of contracts is not developing through case law as well as it ought. The result of this is that there is uncertainty among parties to commercial contracts as to the legality and enforceability of several important commercial arrangements (Hatti and Badami 2012).

These problems have been recognised. The problem affecting commercial contract parties has resulted in proposals that have been mooted to have a commercial division of the High Courts, resulting in the Commercial Division of High Courts Bill (2009) which, although passed by the Lok Sabha (The Lower House of the Indian Parliament), has been referred back to the Law Ministry by the Rajya Sabha (The Council of States of the Indian Parliament) for some changes (PRS Legislative Research 2009).

The second problem, of enabling poor and illiterate litigants to reach courtroom doors, has also been dealt with at several levels, where again legislative intent and de facto conditions face each other across a schism of canyon proportions. While the Constitution of India calls for free legal aid to be provided for those who cannot afford it, the legislative intent is worlds removed from the actual reality—the legal aid centres either have no staff at all or very poorly qualified staff. [This general state of legal aid lawyering brings to mind the tragicomic courtroom scene portrayed by Goscinny and Uderzo and the histrionics of the legal aid lawyer appointed to assist the unwilling protagonists in 'Asterix and the Laurel Wreath' (2007).] To a certain extent, this problem has been overcome in the higher judiciary through the concept of public interest litigation (PIL) or social action litigation (SAL). These matters can be instituted without strict procedural requirements under the CPC such as standing, or written pleadings. There have been instances where the Supreme Court has initiated proceedings suo motu on the strength of letters written to it by aggrieved citizens ('epistolary' jurisdiction), contributing to the 'activist' reputation that the Supreme Court has garnered.

At the subordinate level also, these problems too have been recognized, and measures taken for their redressal, as we have seen in this chapter. While there is a wealth of constitutional, legislative and regulatory directives to ensure justice can in fact be accessed by all, ensuring that the envisioned system lives up to its promises is a far more challenging task.

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Chapter 8
Access to Justice in Latin America: Challenges to Classifying Legal Development in the Region

Helen Ahrens

8.1 Introduction: How Is Latin America Perceived?

- As a matter of principle, Latin American constitutions and laws safeguard a broad concept of access to justice. This concept focuses on the courts and other institutions of administering justice and additionally, addresses the process of law making, the contents of the law, the legitimacy of the courts, alternative modes of legal representation and dispute settlement. Today, in spite of this wide range of expectations, state courts are at the center of demands for a more efficient delivery of outcomes that are fair and accessible to all, irrespective of wealth and status.
- Most Latin American legal systems were initially based on Civil Law. They have, historically, constructed their national legal discourse in deeply transnational ways. However, up to the present day, Latin America has received inputs not only from civil law countries, but also from the United States of America. Furthermore, many Latin American countries accept the premise that traditional indigenous legal systems have a rightful place within the modern state. All these influences have led to an "internal" diversity of national legal orders and a plurality of underlying, co-existing values that lead to a kind of fragmentation of national legal systems.
- Within the last 20 years, the main literature in the field of Latin American legal studies described a Latin American tradition of law as one of lawlessness, legal formalism, an unbridgeable gap between law and society, legal ineffectiveness, judicial inefficiency, and official corruption. The currently prevailing diagnosis is based on the paradigm of legal families as understood by legal origin theory and grounded on the rule of law's most important features, such as neutral decision-making, objectivity, and judicial independence. These features are

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rarely attained in a completely satisfactory way anywhere in the world, projecting these shortcomings onto Latin America in particular, obscures the growing importance of law making, legal discourse and legal institutions in the region.

- Subject-matters such as consumer protection, the social function of property, freedom of expression, indigenous rights, prevention of discrimination against women, the balance between economic development and environmental protection have become issues for litigation, augmenting the presence of courts in Latin American social and cultural life. In particular, magistrates' newly discovered power of reinterpretation of laws has helped to enforce presently existing rights more effectively. But, courts are only as good as the laws they uphold. The conclusions on perspectives of, and the scope for, further judicial development will concentrate on the change in the understanding of law and law making in Latin America.

8.2 The Concept of Access to Justice as Understood in the Latin American Region

In the 1970s, the Italian jurist Mauro Cappelletti directed a research project on "access to justice in modern societies" known as the Florence Access-to-Justice Project. It resulted in a four-volume collection that represented an inventory of access to justice information and considerations especially for Europe and the United States of America (USA). According to Cappelletti, "effective access to justice can be seen as the most basic requirement, the most basic human right, of a system which purports to guarantee legal rights."

At the time, when the Florence Access-to-Justice Project was carried out, some Latin American countries (Argentina, Brazil, Chile, Panama and Uruguay) were facing the return of singularly brutal military regimes while Bolivia, Guatemala, Haiti, Nicaragua and Paraguay had already experienced dictatorships for a considerable period. Other parts of the continent (Colombia and Mexico) were affected by the emergence of drug cartels. A concept like "effective access to justice" that emerged especially from the new social rights movement was not a topic of discussion in Latin America at that time.

From the mid-1980s nearly all Latin America countries, discarding their military regimes, constructed an often painful return to democracy. Many new (as well as the several older but profoundly modified) Latin America constitutions were crafted from the late 1980s through the 1990s integrating a significantly expanded catalogue of (human) rights and aiming to consolidate their democracies. The strengthening of the rule of law is strongly interlinked with the process that led in the 1990s to judicial reforms to increase the independence and authority of the judicial branch. Most of the initiatives reflect a strong sense of frustration with the apparent

lack of responsiveness of the judiciary to achieve these desired results (DeShazo and Vargas 2006).

It has to be mentioned, that the constitutions and reforms in the late twentieth century arose in the context of political as well as economic transformations (O'Donnell 1993). Alongside democratization, Latin America was also witness to the demise of mid-century models of economic development and social provision. The "developmental state", the "planning state" as well as the traditional "welfare state" were assailed in the name of free markets and neoliberal reform. Cappelletti (1981) correctly noted in a publication from the beginning of the 1980s: "this fear (costs of a welfare state) threatens not only the access-to-justice movement, but also the entire vision of a welfare state on which that movement has been constructed". Thus, effective access-to-justice was not a topic of discussion during that period either.

At the beginning of the twenty-first century a decade of natural resource-driven growth was experienced by Latin American countries, this reduced poverty and created a stronger middle class from Tierra del Fuego to the Caribbean (Cruces 2012). Nowadays, as a kind of backlash against orthodox neoliberal reforms, a more educated and politically active citizenry demands more social justice and concern for minority rights (Americas Barometer Insights: 2013, No. 93). Political claims more often are put into legal forms. Activists throughout the region increasingly use the courts as a stage for their struggles and as a portal through which to import favorable international norms (Couso et al. 2010).

It took Latin American countries some decades to develop this broader concept of access to justice (Lovatón Palacios 2009). As with the concept of the rule of law, there is a narrow and a broad approach. The narrow concept focuses on the courts and other institutions of administering justice, and with the process whereby a person presents her case for adjudication. The broader concept addresses, in addition, the process of law making, the content of the law, the legitimacy of the courts, alternative modes of legal representation, and dispute settlement. Internationally, as in Latin America, there is a tendency to a broader concept of access to law. Similar broad definitions can be found in the manual published by United Nations Development Program (2005) about public politics for access to justice, or more recently, in Access to Justice in Europe (FRA 2011) or the Access to Justice Assessment Tool published by the American Bar Association (2012).

In spite of this broad concept of access to justice, there is a widespread belief throughout Latin America that no viable alternative dispute resolution mechanisms exist in Latin American countries. For this reason, the region needs an efficient judicial sector to foster private sector development within the recently established market system (Duce et al. 2012). To this end, the capability of state courts to satisfy the demand for dispositions has been one of the aspects of Latin American judicial reform strategies that have been growing in importance.

8.3 Sources of Latin American Substantive Law and Judicial System

While most Latin American Systems are based on Civil Law (Merryman and Perez-Perdomo 2007), they have constructed their national legal discourse in deeply transnational ways. Latin America receives inputs not only from civil law countries but also from the USA and seems to transform these materials more than other regions. Three reasons suggest themselves for this. Firstly, most of the Latin American countries have been independent for much longer than other former colonies, this gave them the time to emancipate themselves from the core countries' legal models (Kirat 2013). Secondly, the former colonizers, Spain and Portugal, were economic backwaters and dictatorships for much of the twentieth century, which limited the appeal of transplants from there. As soon as Spain reverted to democracy, it reemerged as a legal influence in Latin America. In particular, the 1978 Spanish Constitution was highly influential in the Latin American democratization of the 1980s. Finally, economically and militarily, Latin America has been dominated for a good century by its neighbor, the USA, which could not but direct attention to US models.

Since the beginning of the new millennium, several bi- and multilateral Free Trade Agreements between the USA and Latin American countries have come into force that have had an impact on the national legal framework for investors, the protection of intellectual property, competition law, workers and environmental rights (Clarkson (2002) calls this development an 'Americanization of Latin American law' especially the Mexican case under North American Economic Area—NAFTA). Beginning already in the second half of the twentieth century, there were more young Latin American lawyers who went to the USA for graduate legal studies, than to Europe as their fathers had done (López Medina 2004). Apart from this development, European, especially French, scholars are considered, even to this day, the pinnacle of legal authority by Latin American magistrates, even before the domestic scholars, and as such they are constantly cited by Latin American lawyers (Esquirol 2011b). And judges' role models (in particular activist judges) are still to be found in Italy and Spain, rather than in the USA (Merryman and Perez-Perdomo 2007).

It should be mentioned within this context, that, in the search for transnational offers in taking positions on questions of legal interpretation, Latin American lawyers tend to cite core materials that are in one way or another outdated. These materials are used in a discourse that is of an entirely different type than the discourse in the source countries, or at least its contemporary discourse. In particular, theoretical questions are discussed citing for example many Europeans from the first half of the twentieth or even the nineteenth century, but few if any court decisions or modern European works are cited (Urbina Sánchez et al. 2011). In spite of the invocation of authorities from the core countries, the discourse is distinctively Latin American. Until now, this phenomenon has, at most, been described,

but it has not been developed further. Its importance for legal development in Latin America remains open at present.

In addition, many Latin American countries accept the premise that traditional legal systems have a rightful place within the modern state. The Montecristi Constitution of 2008 declares Ecuador a plurinational nation. Bolivia followed this example in the Bolivian constitution of 2009 that additionally created a new indigenous judicial system, at the same level as ordinary justice, along with a new Plurinational Constitutional Court. The two systems, however, are highly divergent. The challenge of creating functional pluralistic legal systems that respect indigenous peoples' right of self-determination, acknowledge international human rights obligations, and institutionalize a means of adjudicating outcomes when indigenous and national formal legal systems clash, still has to be met.

The legal systems in Latin America today incorporate distinct legal sources. These lead to an "internal" diversity of the national legal order. The lack of a clear abrogation of norms over time (when enacting new law) leads to a plurality of underlying, co-existing values. In the absence of legal unity there is a kind of fragmentation of national legal systems characterized by conflicts of law and values. In this process, the prevailing nineteenth century ideal of a unified national legal culture is eroded and continues to challenge the role of the nation-state in the creation of a central regulatory framework. This shows that legal order in the modern Latin American nation has become very much more complex than they were in the days of the traditional relationship between the citizen and the nation-state.

Whether present day Latin American legal systems might be called "hybrid" or "mixed", or whether its own legal system is emerging, still remains to be seen. What can be said is that there is a lack of an accessible legal order, so the Latin American tradition of law is described "as one of lawlessness, legal formalism, an unbridgeable gap between law and society, legal ineffectiveness, law's inefficiency, and official corruption. The most damning evidence against it (being acceptable) is economic underdevelopment and political instability. Thus, instead of a fertile source experience and experimentation in social organization, the legal tradition described is one of failure." (Esquirol 2011a).

8.4 External Appraisals of Latin American Legal Systems

According to a recently published Rule of Law Index of the World Justice Project (2012–2013), the Latin American civil court systems rank from relatively efficient and independent (Brazil, Chile, Colombia, Dominican Republic, El Salvador, Jamaica, Peru) to inefficient, corrupt and subject to political interference (Argentina, Bolivia, Ecuador, Guatemala, Mexico, Panama, Venezuela). Additionally, for scholars of the "Latin American paradox", according to which there is a huge gap between law on the books and law in practice, especially for the poor (Gargarella 2002), there seems to be no doubt about the poor functioning of the Latin American

legal system. Further support for this finding is seen in the Doing Business Reports of the World Bank (2012–2013) or reports of international law firms.

According to all these sources purporting to measure judicial efficiency, Latin American courts are overburdened and unable to dispose of cases in a timely fashion. As a result, frustrated litigants lose faith in the public justice system's ability to resolve their disputes. This loss of faith, in turn, causes private parties to factor in added costs for judicial delay into their private transactions, and these added costs reduce economic activity and retard economic development. The findings lead to the question of whether possible conflicts arising out of the legal traditions debate might be at stake. In the following section Colombia will be examined as a case in point.

8.4.1 The Case of Columbia

A popular saying in Colombia summarizes the situation referring to rules and structures of civil procedure affecting access to justice as cost and time factors: "It is better to reach a bad settlement than to engage in good litigation". Most recent data from the Doing Business Report (2012) and the sub-national report (2010) seem to confirm this:

At present, on the Enforcing Contracts Indicator of the Doing Business Reports (2012), Colombia ranks 149th (out of 183 economies) in the world. It takes 1,346 days (or 3.7 years) from the moment a case over a disputed amount equivalent to 200 % of Colombia's gross national income per capita is filed in court until the debtor makes a payment. This is more than the double the Latin American and Caribbean (LAC) average of 707.8 days, which is also high by international standards. The cost—at 47.9 % of the claim value—is also above the LAC average of 31.2 %. Colombia is more or less in line with the lowest performing countries within this indicator (Suriname, Panama and Belize). The sub-national report (2010) finds wide disparity in the performance of Colombia's 21 major cities, with the highest delays and costs concentrated in Bogota and Cartagena.

Reforms to improve performance on these indicators are underway. To this end, the National Council for Economic and Social Policy (CONPES) has approved a program referring to the Justice Services Strengthening as described in the Document No. 3559 of December 15, 2008 that is supported by credit from the World Bank. The program addresses needs identified within ordinary jurisdictions (civil, labor and family areas) and those identified with the High Courts. The latest implementation status and results report No. 6 of June 25, 2013 describes the overall implementation progress as satisfactory.

Although there are no exact figures the litigation rate in Colombia seems to be modest to low. The legal culture may be part of this problem, and also helps explain why a relatively low litigation level so thoroughly congests the courts—relatively few cases may be filed, but once in the system, they take on a complex life of their own (Bonivento Fernández et al. 2005). Of course, needless complexity may be in

the eye of the beholder. It can buy time for those attempting to avoid justice and raise fees for legal counsel. Despite changes to the civil procedures code permitting judges to curb superfluous pleadings and motions, the judges are so far cautious in exercising these powers.

Reforms to the ordinary judiciary date back to the 1960s. The Decree 528 of 1964 was the first attempt at a sector-wide reform. Because of its patchy outcomes a second effort began in 1971 whose poor results led to a third attempt in 1987 (Younes Moreno 2012). Since the Constitutional reform of 1991 there is an ongoing reform process of judicial organization. A number of commonly understood reasons explains why the situation is as it is. The underlying causes can be organized into endogenous and exogenous reasons (Bonivento Fernández et al. 2005).

Endogenous reasons are mentioned in CONPES No. 3559 of December 15, 2008:

- The main problem is seen in insufficient and inadequate output due to poor quality and quantity of the judicial actions, which lack timeliness, are inappropriate and have high costs. As regards the courts, the document mentions that litigation rates and average caseloads are medium low for the region. The clearance rate (annual dispositions over new filings) has been rising, and for 2007, was 95 % for the judiciary as a whole. Of course, that did nothing to reduce the backlog of cases resulting from years if not decades of underperformance.
- The second main problem points to poor management practice. Although there are improvements in the sector, the structure of *Consejo Superior de la Judicatura*, partly set by the Constitution and by ordinary law, is evaluated as very cumbersome. In general, judges seem unused to the rigors of management, strategic planning, proper analysis, and implementation. Because of the absence of a strategic vision it is evident that planning tends to be short term, and while every office has projects it wants financed, whether large or very small, none appear linked to a longer term development plan—although 5 years plans are established.

Exogenous reasons are mostly mentioned as causes that ask for a change within judicial practice in order to provide a forum for the fair and effective resolution of disputes. Within this context are mentioned:

- Normative scattering makes it difficult to understand and enforce the applicable legislation. Such a situation is generated by the absence of a unified system clarifying which provisions are in full force and effect, and which have been abrogated within a continuously changing legal landscape.
- In a region known for complex and rigid legal frameworks, Colombia may still be an extreme case. The statutory (organic) laws and even the procedural codes are filled with details that are difficult to satisfy in the Colombian context.

Accompanying these tendencies, and perhaps partly explaining them, is another characteristic—what is traditionally called "legal formalism". This refers to a focus on form over substance, where the form relates to meeting deadlines or other basic procedural requirements. What CONPES does not mention explicitly, but which is

seen as an underlying attitude, is the tendency to see laws as an end in themselves, not as a lever to encourage behavioral change. Furthermore, the distrust of power is so strong that every time it is increased in any area there is an immediate move to set up a countervailing organization. Similarly, there seems to be an outdated model governing the way Colombians perceive their justice institutions and relate to them. The average citizen does not appear to sufficiently trust the courts nor see them—or the relevant dispute resolution mechanisms—as a relevant venue for them to seek justice.

The latter was uncovered by a study by Fedesarrollo (2008) trying to identify unmet needs for conflict resolution and distinguish their incidence between poor and non-poor populations by conducting household surveys in small and medium urban centers (Bucaramanga, Buenaventura, Ciénaga, and Santa Marta). The most important finding is that physical barriers are less important than those of perception: individuals distrust the formal structures, after they have had experience with them. This type of solution is rejected because of anticipated delays and complexities, and the greater use of formal alternatives (the relevant non-judicial agencies) by the non-poor. A recently conducted study on judicial needs re-confirmed some of the unanticipated findings of the former one (Dejusticia 2013).

Taken together these elements paint a picture of a justice system in the region effectively incapable of performing the functions expected, especially as concerns access to justice. Further, they seem to nourish the overall diagnosis of a failed law system that has become a permanent perception in the region. Legal origins theory wants to understand whether or not this situation stems from the fact that Latin American civil law originates from the France tradition.

8.4.2 Differing Opinions on the Classification of a Latin American Tradition of "legal failure"

There are numerous criticisms of the enduring "legal failure" of Latin America as being due to its legal origins. While liberal law's most important features, neutral decision-making, objectivity, judicial independence, are poorly represented in Latin America, these features are rarely accessible in any satisfactory way anywhere in the world, as World Justice Project (2012–2013) proves. Thus, identifying these shortcomings in a particular way with Latin America would need robust justification in order to avoid undermining the credibility of national law (Esquirol 2011a).

During the transition to the market economy in the late 1980s and during the 1990s there was a rise in the number of cases before the courts referring to conflicts following a bankruptcy, the closure of important industries, or the dismissal of workers. Deregulation and the complexity of commercial operations increased the numbers of judicial conflicts during the transition to open market economies (Correa Sútil 1999). In parallel, claims emerged engaging a central feature of the

rule of law: equality of all before the law. In addition, a change in the legal reasoning of judges and magistrates has been seen. Although, of course, legal reasoning varies from country to country, a general shift in legal interpretation was seen in the region. "Whether debating *nuevo derecho* in Colombia, *principologia* in Brazil, the proportionality principle in Mexico, or plurinational hermeneutics in Bolivia, the background framework for these discussions is much the same: new interpretive theories are marshaled against the conventional practices of national courts and traditional commentators, which are (then) in turn dismissed as pure legal formalism" (Esquirol 2011b).

An example of this is the change in reasoning of civil law magistrates within the context of the landless rural workers movement in Brazil and their struggle for access to law and justice. As Sousa Santos and Carlet (2010) demonstrate, the argument of compliance with the requirement of the social function of property was introduced into civil law suits after the principle was enshrined in the Federal Constitution of 1988. In the beginning, magistrates based their arguments solely on the Civil Code and its strict concept of property. This attitude changed when magistrates started to interpret the law, entering into dialogue with the Federal Constitution and the doctrine of fundamental human rights.

The case of Brazil is not the only one. The Constitutional Court of Colombia in several cases referring to the access to health services as well as a recent Supreme Court of Chile case referring to consumer protection may also be cited. These examples show that in recent years several (high) courts have begun to cast themselves as defenders of rights and to intervene in significant political controversies. Thus, today, the role of judges in Latin America is undergoing a change comparable with that of other civil law systems where judges are more and more inclined to follow precedents and a good deal of case law has been built up to assist in the interpretation of statutory codes.

The newly discovered power of magistrates in the wake of democratic transitions, changing social attitudes, and widespread popular demands for judicial services has encouraged the growth of institutional reforms, the importance of law, legal discourse and legal institutions in Latin America. As Pérez-Perdomo (2006) argues, the latest round of attacks on judges owes more to their increasing importance in the political sphere and less to the traditional view of judges as simply mechanically applying of the will of legislators to particular cases.

However, there is a significant lack of sorely needed diagnostics, statistics, evaluations, and other monitoring tools to confirm the new role of courts and judges. There are no clear trends in the region that can be identified. Either opinion may be right. That is to say, it may be that the problem of discontent with the judiciary and its reforms comes from providing court-based solutions instead of providing alternative conflict resolution mechanisms. Or it might be said that courts and judges are discredited because they are complying with the principle of equity before law. The observer is left more than a little perplexed by this unclear situation.

Nonetheless, what can be clearly said is that legal systems are not independent, 'exogenous' forces that legal origins theory takes them to be. It is obvious that

"legal systems are, to some degree, 'endogenous' in the sense of being shaped by their economic and political environment" (Armour et al. 2010) which leads us to the laws and the finding that courts are only as good as the laws they apply.

8.5 A Final Word in Conclusion

Law is ascribed a threefold function: (1) it carries the structures and systems of society through time; (2) law inserts the common interest of society into the behavior of society's members, and (3) law establishes possible futures with society's theories, values and purposes. In other words: Law is the presence of the social past; it is an organizing of social present and law is conditioning the social future.

Thus, law can be seen as the record of a society's most important commitments and its most elevated goals. Legal debate and law making at the national and local levels is an important dimension of democracy. It is not simply the province of legislators, judges, and lawyers it is also widely dependent on a class of legal commentators, critics, scholars, academics, and informed citizens. It is served by a dedicated class of individuals that can contribute to societal discussions and disagreements about political priorities, policy deliberations, institutional re-design, and the specific legal reforms best suited to implement them.

It appears that advanced legal expertise is an important aspect of the rule of law. It is not a luxury reserved only for wealthy societies. It is a necessity in terms of explaining, debating and defending a society's system of laws and the policies that are inscribed in them. Indeed, promoting the national rule of law is an important element of sovereignty. Moreover, in a globalized world, with pressures for greater uniformity, important precepts generated by the will of local peoples are harder to defend and reinforce. Even at a national level, local legal imperatives require a community that can articulate the strengths and legitimacy of alternative arrangements. For modern societies, the Law requires leadership and expertise.

There is no doubt that local and national discussions are taking place in Latin America around key issues such as competition law, intellectual property law and so on. But the way discussions take place depends on the type of democracy any given nation is experiencing. At present, there are indicators of the decline of democracy in some Latin American countries (especially Bolivia, Ecuador, Nicaragua and Venezuela). Some of these societies and their governments either tolerate the erosion of democratic institutions or deliberately undermine freedoms in order to marginalize potential sources of political opposition. In particular, the press has become a principal target for left-populist leaders, notably in Venezuela, Argentina, Ecuador, and Nicaragua. Tactics include a massive expansion of state-controlled media (especially in television), the use of punitive libel laws to silence critics, and the abuse of licensing powers to threaten or shut down critical media. A judiciary neglecting its power of judicial interpretation opens the way for corruption and the

political control of elections, the press, the economy, and civil society, as recent experience has demonstrated.

These political developments are of deep concern in the region. At the opening ceremony of the Third Latin American Democracy Forum in Mexico City in 2012, Secretary General of the Organization of American States (OAS), José Miguel Insulza, said "in many of our countries, . . . dialogue has been replaced – whether by the facts or by way of political confrontation – by the existence of tight divisions that turns every democratic election into almost a last resort, and that is not good for democracy either." He continued saying that "a democratic society, in which all individuals have equal political rights nominally, is incompatible with the degree of inequality that exists in our countries in economic and social terms."

In addition to the embedded nature of law within a political environment and its application by the judiciary, a more "technical" problem, which must be overcome, threatens the efficiency and predictability of the justice system: the fragmentation of national legal systems. The historical changes that took place in Latin American legal systems challenge both the structures of legal control mechanisms as well as the central tenets of the law. In turn, they are associated with fundamental challenges, especially with regard to legal policy. Pluralism and the fragmentation of law need not necessarily be disadvantageous. A prerequisite for its positive evaluation is not only the successful integration of the various orders, but also the compatibility of the central value decisions.

At present, there is no institution in any Latin American country that stimulates discussions in the above-mentioned areas or that coordinates regulatory development and reviews proposed or final rules. The lack of what in German is called "*Rechtspolitik*" ("legal policy") throughout Latin America shows their diverse approaches to the understanding of law and the judiciary. In connection with this finding the question arises as to how the future legal order will be constructed in Latin America: will it be based on politically and strategically-oriented management of various legal sources? Or will interest groups—outside the political mainstream—continue developing their own "living law" on the "periphery of (state) law" in fragmented and individual ways, as Eugen Ehrlich predicted in 1913 for far-off Bukovina of the Austrian Empire? The future development of legal systems in Latin American countries will determine the answers to these questions. To understand this, the process needs to be further studied and examined.

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Chapter 9
Access to Justice in Indochinese Countries

Hiroshi Matsuo

9.1 Introduction

This chapter analyzes the current state of access to justice in Indochinese countries, identifies probable determinants of access to justice in these transforming countries, and considers possible measures for the promotion of access to justice within the parameters of the legal development process in those countries.

First, I will discuss various concepts of access to justice and propose an integrated approach. I will then use that approach as a conceptual framework for analyzing the current state of access to justice in Vietnam, Laos and Cambodia. Finally, I will examine some elements, which influence, facilitate or prevent access to justice in these countries. The purpose is to search for measures, which appear most adequate to promote access to justice while taking account of both similarities and differences of the conditions in the three countries.

9.2 The Concept of Access to Justice

9.2.1 Social and Economic Access

Access to justice is a protean concept and it has various dimensions. Ross Cranston draws a distinction between social access and economic access (Cranston 1997 at pp. 233 and 255). The social access puts emphasis on assisting the poor, disabled and handicapped people who cannot afford to use the judicial remedy, correcting the illegal or unjust actions of firms and government, enriching the legal measures for the maintenance and promotion of the public interest, and facilitating the

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participation of the entire population in the judicial system. It includes the extension of the legal aid, the representation of specific and collective interests of consumers and environmentalists, the creation of public interest litigation, the inclusion of alternative dispute resolution and informal justice, and the introduction of jury systems or mixed courts with lay judges, etc.

The economic access aims to implement the rights acquired by economic actors, especially firms and financial institutions, through contracts and other transactions, to protect property rights including intellectual property so that they can minimize transaction costs and maximize investments in economic activities, which may stimulate the national economy. Cranston notes that in many societies the focus has rightly been on social access, and economic access has not been a pressing problem, since wealth guarantees access to the courts and legal services. However, in South and South-East Asia neither social nor economic access has been achieved (Cranston 1997 at pp. 233 and 255).

9.2.2 Procedural and Substantive Aspect

From the procedural aspect, access to justice means the ease with which every individual can address any preferable category of the justice system, which is not limited to the judicial system such as court procedures but may extend to various measures of (alternative dispute resolution) ADR and even informal justice.

However, as the term "access to justice" further implies, it has also a substantive aspect, which provides the citizens with a relief protecting their justifiable interests or realizing their just claims (Cappelletti and Garth 1978, pp. *i,* 1–4). Access to justice is to make rights effective.

9.2.3 Individual and Comprehensive Focus

Access to justice can be regarded as an indispensable means to combat poverty as well as to prevent and resolve conflicts (UNDP 2004, p. 3). In this context, access to justice is regarded as a basic human right of the individual, especially of the poor, marginalized and disadvantaged, including women, children, minorities, and people living with HIV/AIDS and disabilities (UNDP 2005, pp. 3–7, 170). Thus it is characterized as a "bottom-up" approach to legal development as compared to the "top-down institutional reform" (van de Meene and van Rooij 2008, p. 6).

However, it must be noted that the importance of the state is also recognized in the promotion of access to justice by measures such as strengthening judicial independence, court reforms, the training of judges, prosecutors, law enforcement officials, making legislation more pro-poor, and combating corruption (van de Meene and van Rooij 2008, pp. 19–20). Strategies for promoting access to justice include comprehensive reforms, which involve both government and

non-governmental organizations in the process of developing and transforming countries.

9.2.4 *Access to Justice as a Part of the Rule of Law Promotion*

It is also widely recognized that access to justice is an indispensable element of the rule of law (Trebilcock and Daniels 2008, pp. 237–238). For instance, the rule of law index compiled by the World Justice Project (WJP) includes access to justice as one of its four major pillars: accountable government—security and fundamental rights—open government and effective regulatory enforcement—and access to justice (WJP 2012, pp. 10–14; WJP 2012, pp. 9–17). Access to justice here consists of factors such as access to civil justice, effective criminal justice, and informal justice. As an indicator, it measures whether ordinary people can peacefully and effectively resolve their grievances in accordance with generally accepted social norms rather than resorting to violence or self-help. It is to be provided by competent, independent, and ethical adjudicators, attorneys or representatives and judicial officers who are present in sufficient number, have adequate resources, and reflect the makeup of the communities they serve. It focuses chiefly on the legal representation and access to the courts (as well as ADR and informal justice) in the limited sense of access to justice rather than in the broader sense in which it is seen as synonymous with legal empowerment of the poor and disfranchised. But access to justice in this limited sense is nonetheless regarded as a critical cornerstone for the implementation of policies and rights, which empower the poor (WJP 2012, pp. 9–10, 13; WJP 2012, pp. 9–10, 15, 17).

Country Profiles for Vietnam and Cambodia along with their rule of law scores of the WJP's Rule of Law Index 2011 are shown in Table 9.1. Corruption indicators in the Worldwide Governance Indicators are also shown in the table.

9.2.5 *Access to Justice as One Aspect of Good Governance*

However, access to justice in the narrow sense presupposes the existence of a series of substantive law to be applied on the one hand, and it needs to be sustained by an effective judiciary bound by procedural rules on the other. For instance, the quality of the courts, which is one of the major elements of access to justice, is also regarded as an indispensable factor of the rule of law that is closely related with the governance factors of the state as is shown by the Rule of Law Index as a part of the World Wide Governance Indicators (World Bank 2012).

The judicial system plays a significant role in the process of development, mainly for three reasons. First, it is indispensable to resolve disputes between firms and citizens concerned with market transactions. Second, the judiciary plays

Table 9.1 Access to justice and related data in Indochinese countries

	Vietnam	Laos	Cambodia
Population	90,549,390 (2011)	6,560,000 (2011)	15,300,000 (2010)
Literacy	93.5 % (2009)	72.7 % (2005)	77.6 % (2008)
Male/female	95.8 %/91.4 %	82.5 %/63.2 %	85.1 %/70.9 %
Mean years of schooling	5.5	4.6	5.8
Life expectancy	75.2	67.5	63.1
GDP per capita (US$)	1,362 (2011)	1,204 (2011)	912 (2011)
Growth rate	5.89 % (2011)	8.26 % (2011)	6.09 % (2011)
Access to civil justice[a]	0.43	–	0.37
Global ranking	79/97	–	94/97
Rule of law (WGI[b])	38.9	21.3	12.8
Corruption (WGI[b])	33	13.9	7.7
Number of courts			
Family courts	–	–	–
District courts	630	56 (17+39)	23
Appellate courts	61	3	1
Supreme court	1 (2 branch offices)	1	1
Number of judges	4,680 (2011)	375 (2011)	271 (2011)
Per 100,000 population	5.4	5.9	1.8
Unified exam	No	No	Yes
Practical training	Yes	Yes	Yes
Number of prosecutors	7,590 (2011)	348 (2011)	144 (2011)
Per 100,000 population	8.2	5.4	0.9
Number of lawyers	6,559 (2011)	144 (2011)	639 (2011)
Per 100,000 population	7.4	2.3	4.2
Unified exam	No	No	Yes
Practical training	Yes	Yes	Yes
Number of civil cases	177,417 (including	2,526 (including	–
First instance	family cases	family cases	
Appeal to App. Ct.	2009)	2009)	
Dismissal	–	621 (2010)	
Appeal to Sup. Ct.	–	194 (2010)	
Dismissal	–	452 (2010)	
	–	97 (2010)	
Content of cases in the first instance court			
Civil matters	–	1,555	–
Contracts	–	c. 500	–
Family matters	–	689	–
Commercial matters	–	177	–
Number of family cases at the first instance court	–	951 (2011)	–
Clearance rate at the first instance court	–	c. 5–10 %	–
Number of criminal cases at the first instance court	65,462 (2009)	3,017 (2011)	–
Class action	Generally no	Generally no	No
Small claims procedure	No	No	Yes (2011)
Compromise in-court	Yes (2004)	Yes (1990)	Yes (2011)

(continued)

Table 9.1 (continued)

	Vietnam	Laos	Cambodia
Out-of-Court Conciliation	Yes (2004) Head of People's Committee Village Conciliation Board	Yes (1990) Village Conciliation Board	Yes Head of commune
Arbitration	Yes (1995)	Yes (1998)	Yes (labor, commercial matters) (2006)

Source: Author's own computation
[a]World Justice Project (2012)
[b]World Bank (2012)

an important role in controlling deviation or abuse of strong government powers exercised for the implementation of development policies. Third, the judiciary may be able to prevent radical legislation, which may be envisioned by a newly established legislature resulting from a democratization wave in a multiethnic society but going beyond the limits prescribed by the constitution. Thus the judiciary may be the core organization to manage the governance of the state by keeping a balance between markets and business, government and civil society. In this context, access to justice is regarded as one aspect of good governance (Cranston 1997, p. 255).

9.2.6 An Integrated Concept of Access to Justice

Taking into consideration the various dimensions mentioned above, access to justice might be conceived as a ubiquitous system comprising a seamless web of legal services, supported by three pillars. These are (1) comprehensive and consistent rules of substantive and procedural law, (2) an effective and efficient justice system comprised of a judicial system managed by competent judges and prosecutors, complemented by appropriate measures of ADR and an informal justice system coordinated with the formal one, an active role for lawyers, and the provision of legal aid, and (3) the citizens' knowledge about, and understanding of, the legal system, their attitudes and expectations toward the justice system, and their awareness of legal problems. From this perspective, I will analyze the assumed determinants of access to justice in Vietnam, Laos and Cambodia, and ask how they might relate to the evolution of the justice systems in other developing and transforming countries.

9.3 Current State and Assumed Determinants of Access to Justice in Indochinese Countries

9.3.1 Vietnam

9.3.1.1 Overview of the State

Ten years after the unification in July 1976, the Socialist Republic of Vietnam adopted the *Doi Moi* (Renovation) policy at the 6th Congress of the Communist Party of Vietnam in December 1986. Since then, it has promoted a carefully managed transition from the former planned economy to a "socialist-oriented" market economy. It joined ASEAN in July 1995, APEC in November 1998 and WTO in October 2007. However, the rapid expansion of the market economy has not covered the whole country which consequently created dual economies splitting the society, parts of which are subject to the formal institutions and those still subject to informal institutions. In 2011, the population was estimated at 90,549,390, in a land area of 329,251 km^2. GDP per capita was reported to be US $1,169 with a growth rate of 5.89 %, declining from 6.78 % in 2010.

9.3.1.2 Legal Reform

In order to promote the transition to a market economy and to attract investment, the government of Vietnam has promoted a series of legal reforms under the Constitution 1992, which recognized the right to transfer land use rights. These reforms included the legislation of the Land Law of 1993, the Civil Code of 1995 (amended in 2005 and again to be amended in 2015), the Foreign Investment Law of 1996 (amended in 2000 and integrated into the Common Investment Law 2005), the Promotion of Domestic Investment Law of 1998, the Civil Procedure Code of 2004, the Bankruptcy Law of 2004, the Enforcement of Civil Judgments Law of 2008, etc. Major legislative revisions within various categories of commercial transactions are considered to be virtually completed through the 1990s and 2000s. As a result of the rapid pace of legal reforms in various fields, there have been some inconsistencies within laws as well as between laws. Some areas still lack the necessary laws and regulations. There have been priority confusions between legislated laws and executive orders issued by the government.

However, the Vietnamese government has continuously promoted legal reforms through trial and error for nearly 20 years in a characteristic manner. First, it has collected comments from foreign governments and international organizations on the particular provisions of laws drafted by the Vietnamese. Second, Vietnamese legal reforms have not merely consisted of the direct introduction of foreign laws but have improved and adapted them in a process so as to accommodate the economic, political and social situation of the country.

For instance, the Civil Code 1995 recognized the institution of common property owned by "the family household" as a subject of rights (Art. 116), though the rules on the scope of the members of the household and how to dispose of that common property were not sufficiently clear. Although legal advisors of foreign donors repeatedly indicated problems, the institution was kept in the amended Civil Code 2005. However, the new code introduced some rules on the disposition of common property held by the family household (Art. 109, Para. 2). Thus the traditional rule based on the notion of common family household property was adapted to market rules step by step.

Third, the Vietnamese Civil Code has been increasingly reflecting features of a German-style civil code known as the *Pandekten* system in the course of its amendments. For instance, the recent preparation for a further amendment to the present Civil Code of 2005 includes a plan to introduce the clear division of property rights into real rights (*Sachenrechte*) and claim rights (*Forderungen*).

9.3.1.3 The Justice System

The Judiciary

The Courts and Civil Procedure

In Vietnam, there are about 630 district courts, 61 provincial courts, and the Supreme People's Court (SPC), which has one main office and two branches.

As of 30 September 2011 the number of judges was 4,680 (plus 140 judges in the military court) and that of prosecutors 7,590, plus 390 military prosecutors (JFBA and JICA 2011, p. 1).

Based on the principle of democratic centralism, all governance power is concentrated in the National Assembly, which distributes powers to the judiciary and the executive. The power of judicial administration within the SPC was granted to the SPC itself, but the power of judicial administration of district courts and provincial courts including that of budget allocation was granted to the Ministry of Justice.

The number of civil cases (including the family law cases) was 177,417 and that of criminal cases was 65,462 in 2009 (JFBA and JICA 2011, pp. 1–2). It is noteworthy that the number of civil cases is relatively large, for example 30 times higher than that of Laos (see Table 9.1). The civil procedure is based on the two-tier adjudication system (Art. 17, Para. 1 Civil Procedure Code). The most salient feature of the Vietnamese civil procedure is the institution of ex officio initiatives by "the People's *Procuracy*" as well as by the court. The People's *Procuracy* is vested with the power of public prosecution and supervision of judicial activities to ensure the strict and uniform observance of the law in accordance with the provisions of the law. As opposed to public prosecutors representing the government as in other countries, it directly represents the National Assembly. It is called *procuracy* to clearly distinguish it (Art. 137, Para. 1 Constitution). The head of

the *procuracy* is vested with the power of appeal against the decision of the court of first instance; the power of filing a petition against the decision of the court of appeal because of a serious violation of law even though the parties do not plan to appeal; and the power of filing for another civil procedure following the discovery of new facts which might substantially change outcomes and which were not known to the courts and the involved parties when the courts rendered their decision (Art. 44, Para. 1, Art. 285, Art. 307 Civil Procedure Code). The prosecutors have the power to attend a civil procedure and state an opinion in accordance with the law (Art. 21, Art. 45, Art. 207 Civil Procedure Code). However, it should be noted that the powers of the *procuracy* of filing a civil law suit was abolished, and the power of attending civil procedures and stating an opinion have been limited to certain cases such as where the parties complained about the evidence collected by the court or second instance procedures if the *procuracy* had filed an appeal (Art. 21 Civil Procedure Code).

The judge is also vested with the powers to collect evidence even before the civil procedure, and if the judge thinks that the evidence included in the records provided by the parties is not sufficient to resolve the case, he/she may request the parties to submit additional evidence (Art. 85 Civil Procedure Code).

There seem to be several reasons behind the ex officio initiatives by the *procuracy* and the court even in civil procedures. One is the scarcity of lawyers who can assist the parties collecting evidence and also plead convincingly in the civil procedure. Another is a belief in the consciousness of the government officials as well as of the ordinary people that the court, supervised by the *procuracy*, has a duty to find the "truth" and, on the basis of it, to reach the "correct" resolution of the conflict, rather than to judge the (relative) merits of the claim between the parties. As a result, the court decision is made by the panel after the civil procedure even when the defendant did not plead or even attend the civil procedure (Art. 60, Para. 2, Art. 202 Civil Procedure Code). The panel for first-instance civil procedure cases is composed of one judge and two people's jurors and that for appellate trial is composed of three judges (Art. 52, Art. 53 Civil Procedure Code).

A summary procedure for some special cases such as the small claims action is yet to be introduced, though the donors recommended it.

Class action and public interest litigation has not been adopted generally. However, the collective body of employees under certain conditions may bring collective labor disputes between employees and employers into the court. The case must be concerned with disputes over rights or interests related to the job, wages, income and other working conditions, over the trade union, etc. as provided by law. It must have been treated by the labor arbitration board of the province or of the centrally run city. And the parties must disagree with the board's decision (Art. 31, Para. 2 Civil Procedure Code).

The person filing a lawsuit or appeal must pay the court fees and charges in advance. However, if the claim is established and the plaintiff wins the case, the fees and charges may be reimbursed by the State Treasury [Art. 127, Art. 128, Art. 131, Art. 56, Para. 2 (2) Civil Procedure Code].

The fees for lawyers and interpreters shall be borne by each party who has requested their involvement (Art. 144 Civil Procedure Code).

Judges

There is neither a unified examination nor training system for the legal profession such as judges, prosecutors and lawyers.

Judges are nominated by a Selection Committee for each level of the People's Court and appointed by the Head of the State, except for the Chief Judge of the SPC, who is elected by the National Assembly. The qualification criteria include the diploma of a university law faculty or a school for judges, and more than 8 years practical experience for the SPC, more than 6 years for the Provincial Level Court, and more than 4 years for the District Level Court. The term of office is 5 years. After the term of 5 years, the judge may be reappointed. There are indications that the qualification of the judges should be improved.

ADR and Informal Justice

The head of the People's Committee of the Communist Party at the district level has been authorized to conciliate disputes at the request of the conflicting parties. However, he/she will recommend to the parties to bring the case to the court, if the case is concerned with a legal matter.

The head of the village community is vested by the People's Committee at the District Level with the power to resolve the conflict within the community by way of conciliation. The traditional village community has a customary village covenant called "*Huong Uoc*", the oldest of which is traced back to the fifteenth century. The People's Committee seems to incorporate the village community into the administrative organization as the smallest unit. For that purpose, the People's Committee has promoted the policy of codifying the village covenants, and confers the conciliation power on the head of the village community by establishing the Village Conciliation Board and appointing its members based on the Constitution and related regulations (Art. 127 Constitution, and the Regulation on the Organizations and Activities of Grassroots Conciliation 1999). The Village Conciliation Board has jurisdiction over minor cases as provided by the Regulation such as personal discords, domestic troubles, etc., which cannot be sanctioned by criminal or administrative penalty. It must be noted that the Village Conciliation Board is strictly subject to the policies and guidelines of the Communist Party and can expect to be rewarded if it has performed its responsibilities with excellence (Art. 7, Art. 9, Art. 15 Regulation 1999). The Communist party may have sought to establish a "safety valve" against any harmful side effects of the rapid introduction of the market system by re-injecting the basic policies of the Communist Party through to the smallest unit of the incorporated community. This structure should be carefully analyzed and evaluated.

In this context, the People's Committee may be intermediating the dual justice system between informal dispute resolution by the village community based on customary community rules and formal dispute resolution by the courts based on newly introduced laws for the market mechanisms. It may attempt this intermediation based on the policies of the Communist Party. The dual justice system seems to remain firmly established.

The Vietnam International Arbitration Center aims to solve international commercial disputes based on the principles of party autonomy and international standards so as to facilitate foreign investments. However, it is reported that it has not been used frequently so far (Oguchi et al. 2011, p. 11).

Lawyers and Bar Associations

Lawyers

The number of lawyers stood at 6,559 as of 30 September 2011, or 7.4 per 100,000 inhabitants, which is relatively small (JFBA and JICA 2011, p. 1).

In order to be qualified as a lawyer, one must have a bachelor of law degree, complete a training course for 6 months at the Lawyers Training Center with a certificate, and, in principle, do an 18-months probationary period with an organization practicing law. After the probationary period, the candidate lawyer reports the results to the bar association, and the candidate has to pass the bar test organized by the national lawyers' organization. If the candidate has passed the test, he must submit an application to the managing board of the bar association and the Minister of Justice will grant the certificate to practice law within 30 days of the application (JFBA and JICA 2011, pp. 4–5).

Bar Associations

There are 62 bar associations in Vietnam and the Vietnam Bar Federation (VBF) was established in 2009. Lawyers have to be a member of the bar to practice. The membership fee is VN$30,000 per month, equal to about US$1.40 per month (JFBA and JICA 2011, pp. 3–4).

Legal Aid

In 1997, the Legal Aid Department was established within the Ministry of Justice, and under its supervision the Legal Aid Centers were set up in the districts and cities. The related laws such as the Law on Legal Aid and the Law on Lawyers were enacted in 2006. They offer legal consultation, organize legal education programs for citizens including seminars, distribute leaflets explaining the general content of major legal documents, etc. They are supported by foreign donors, such as the Joint Partnership Program (JPP) administered by the EU, Denmark, and Sweden.

They are short of personnel and money and are not easily accessible to citizens. According to a survey conducted by the UNDP (United Nations Development Programme) in 2004 (see Sect. 9.3.1.4); public awareness of the Legal Aid Center was poor. Only 5 % of the interviewees were aware of it. The number was larger in rural areas than in urban areas. The number of users is larger in high-income groups than low-income groups (UNDP 2004, pp. 8 and 12).

While the existing Legal Aid Centers are still administered under the supervision of the Ministry of Justice, the Vietnam Bar Federation is preparing to open legal aid centers on its own initiative. It plans to provide the legal consultations in specific fields such as land, business, and administrative matters, domestic matters, criminal matters, etc. even in rural areas.

9.3.1.4 Agenda for Further Development

Gaps Between Awareness of, Access to, and Confidence in Legal Institutions

The UNDP conducted a survey from 20 May to 18 June 2003 interviewing 1,000 inhabitants selected at random from different gender, income (high, medium, low income) groups and geographical locations (urban, rural, mountainous area). According to the survey, the Vietnamese legal institutions ranked as follows in the people's awareness: (1) the People's Committee, (2) the police, (3) the Village Conciliation Board, (4) lawyers, (5) the courts, (6) the *procuracy*, (7) the judgment enforcement bodies, (8) the state inspectorate, and (9) the Legal Aid Centers (UNDP 2004, p. 8).

As for the accessibility of these institutions, the police and the People's Committee stood out again ranked first and second respectively, each having around 40 % of positive poll responses. Lawyers ranked third with around 10 %, and the head of village community, the Village Conciliation Board, the courts, the procuracy, the Legal Aid Centers came last with less than 10 % in a collective rank fourth (UNDP 2004, p. 12).

Interviewees who had actually accessed legal institutions were questioned about their confidence in these institutions. The responses revealed the following confidence ranking: (1) the head of the Village Community, (2) the Village Conciliation Board, (3) lawyers, (4) the *procuracy*, (5) the courts, (6) the People's Committee, (7) the Legal Aid Centers, and (8) the police (UNDP 2004, p. 8). This suggests the persistence of the dual justice system in Vietnam. However, the confidence in the Legal Aid Center was higher among the interviewees who had actually used it (40 %) than among those who had no experience of it (10 %).

The survey shows that the awareness of, access to and confidence of the people in legal institutions did not correlate and that the gap was serious especially between the awareness and access indicators on the one hand, and the confidence indicator on the other. The gaps suggest four further conclusions as follows.

- First, the people generally had a difficulty to access normal legal institutions such as the courts.
- Second, the people may have had to use the legal institutions reluctantly even though they had no great confidence in them.
- Third, there seems to be a tendency that administrative organizations such as the People's Committee and the police are more familiar and accessible than the judicial system such as the courts. This tendency seems to exist in other Asian countries including Japan. This fact shows that access to justice will largely be influenced by the governance structure, which has long been established in the historical development of the society.
- Fourth, the gap between the awareness and access indicators cannot be overlooked, especially in view of the results concerning the head of village community and the Village Conciliation Board. As a basic condition the people seem to have a feeling that they do not like to give conflicts a legal dimension. This reluctance may be overcome by increased knowledge and understanding of ordinary people about their rights, the law and legal relief, by improved popularity of lawyers (JFBA and JICA 2011, p. 13), and by an emerging custom of resolving conflicts by way of the legal system. The consciousness of legal problems and strong feelings about them may be influenced by the government's policies toward the citizens and in turn influence these policies.

Overcoming the Gap Between the Formal and Informal Justice System

As just mentioned, the gap between the formal judiciary and informal justice system on the community level seems to be persistent. If the standards applied in the two coexisting dispute resolution systems differ largely and the results tend to be different depending on the system the parties chose, the justice system will not work. In order to rearrange these different justice systems into a seamless network of dispute resolution, dissemination of basic knowledge about the substantive and procedural rules is the key, including the rural and mountainous areas of the country. Such dissemination of knowledge is important, irrespective of the degree in the use of the formal justice system at a given moment in time.

Uncertainty of Enforcement of Judgments

There are also indications of a gap between the civil adjudication system, which is administered by the court, and the judgment enforcement system, which is managed by the enforcement bureau of the People's Committee in the same jurisdiction. In the latter system, political pressures may distort the enforcement (Takeuchi 2002, pp. 30–31), which should be treated in a more legally cogent and systematic way. To avoid this problem, the relation between the judiciary and the People's Committee and the Ministry of justice could be reorganized.

The Empowerment of Lawyers

It has been repeatedly indicated that the number and the quality of lawyers should be improved and that corruption should be strictly sanctioned (JFBA and JICA 2011, pp. 11–13).

9.3.2 Laos

9.3.2.1 Overview of the State

Since the founding of the Lao People's Democratic Republic in 1975, the Lao People's Revolutionary Party, a socialist party and the only legal political party, has led the development of the country. It has transformed the economic policy from 1979 and since 1986 has continuously pursued opening the market gradually with the idea of "*Labop My*," the new economic mechanism. In 2011, the population was estimated at around 6,560,000 in a land area of 236,800 km^2. Laos is a multiethnic country, which is reported to have 49 ethnic groups. GDP per capita was US$1,362 in 2011. The economic growth rate was 7.59 % in 2009 and estimated to be 7.93 % in 2010 and 8.26 % in 2011, the highest among Indochinese countries. Laos joined ASEAN in 1997 and is expected to become a member of WTO in the near future.

9.3.2.2 Legal Reforms

In 1990, the Lao government enacted a piecemeal series of statutes concerning economic transactions, such as Property Law, Contract Law, Law of Non-Contractual Obligations, Family Law, Succession Law, and the Civil Procedure Code, which was amended in 2004 and 2012. Of these, the Contract Law and Law of Non-Contractual Obligations were amended and combined as Law of Contractual and Non-Contractual Obligations in 2008. The Family Law and the Succession Law were also amended in 2008. Recently, an amendment of the Civil Procedure Code, the enactment of intellectual property laws and the implementation of the Business Enterprise Law of 1994 have been initiated. Furthermore, the government is planning to consolidate the above-mentioned piecemeal statutes in comprehensive civil law codification. The project of drafting the Civil Code in cooperation with the Japan International Cooperation Agency (JICA) was launched on 8 June 2012 in Vientiane. The legal reform process in Laos is different from Vietnamese and Cambodian cases in that it appears to be more incremental, starting from piecemeal legislation and continuing the necessary amendments in accordance with a gradual process of changes in the economy and society. Nonetheless, it seems to be moving in the same direction as regards the civil law system as evidenced in the planning of a Civil Code.

9.3.2.3 The Justice System

The Judiciary

The Courts and Civil Procedure

There are 56 first instance courts with competence for civil cases, including 17 Provincial Courts, 39 District Courts, and 3 County Courts. Three Appellate Courts provide the second instance, and a Supreme Court the third.

The number of judges is reported to be 375 (plus 29 judges in the military court) and that of prosecutors was 348 as of 2011.

According to a survey arranged and conducted by the author in cooperation with Mr. Osamu Ishioka, lawyer and JICA expert in Vientiane in December 2011 (cited as The Survey 2011 hereafter), the number of civil cases at first-instance courts was 2,526 including 1,555 civil cases in the narrow sense, 794 family cases and 177 commercial cases in 2010.

Out of the 1,555 civil cases, around 500 concerned contracts (contract of sale, loan for consumption, service, construction, transportation, etc.), as were all the commercial cases (177 cases) including 144 cases concerning contracts of sale and loans for consumption (The Survey 2011).

In 2010, 621 civil cases were appealed to the appellate courts, 451 civil cases were appealed to the Supreme Court. Out of 574 judgments of appellate courts, 194 dismissed the rulings of the first-instance court, and out of 498 Supreme Court judgments, 97 dismissed the rulings of the appellate courts. It is estimated that from 5 to 10 % of the cases brought into the first-instance court will be resolved within 1 year (The Survey 2011).

In 2011, the number of civil cases at first-instance courts was 3,129 including 1,888 in the narrow sense, 951 family cases and 290 commercial cases. The number of criminal cases at first-instance courts was 3,017 (JFBA and JICA 2011, p. 1).

The civil procedure in Laos shares with Vietnam the feature of ex officio initiatives by the prosecutors and the courts, though it seems more moderate and, interestingly, the importance of ex officio initiatives is decreasing. Indeed, the court as such is expected to find the truth and to give a correct judgment in the course of ordinary civil procedure, rather than just to decide which claim is superior with the evidence provided by the parties. Thus, if the court finds that the evidence presented by the parties are not sufficient to make a decision, it is authorized to request the parties to provide additional evidence or collect further evidence on its own initiative (Art. 20, Para. 5 Civil Procedure Code 2004).

Still the prosecutor does have the power to participate in the civil procedure, to search for evidence, to make a statement in the trial, etc. (Art. 23, Art. 37, Art. 38, Art. 39, Para. 2 Civil Procedure Code 2004). Additionally, if the civil case is expected to affect the public interest and no private party appears willing to file a lawsuit, the prosecutor (the People's Prosecutors Office) is authorized to bring the case to the court as a plaintiff (Art. 39, Para. 1 Civil Procedure Code 2004). If the defendant does not plead, the court summons the defendant. If the defendant has

pleaded, but does not appear in the trial, the court passes judgment provided it has sufficient evidence; otherwise it summons the defendant to the trial (The Survey 2011).

However, as a result of an amendment to the Constitution in 2003, the power of judicial administration was transferred from the Ministry of Justice to the Supreme Court, which seems to facilitate the independence of the judiciary. Noteworthy is the abrogation of the power to file for cassation against a legally valid decision, which is still maintained in Vietnam as stated above (see Sect. 9.3.1.3). Furthermore, in the recent discussions between the Supreme Court and the Prosecutors Office concerning a draft amendment of the Civil Procedure Code, the Supreme Court appears to be of the opinion that the power of the prosecutors to participate in the civil procedure should be much more limited. The Prosecutors Office is against such a limitation arguing, "Who else will guarantee the correctness of the judgment?" (The Survey 2011). This is quite an interesting discussion between the Supreme Court and the Prosecutors Office and it seems that the judiciary has just embarked on a long process step by step towards its independence. The Lao Bar Association, in turn, is drafting a statute concerning lawyers so as to consolidate the independent status of lawyers.

Judges

In order to become a judge, a candidate must have a career starting in the technical staff at the court, passing through the stage of service as an assistant judge, and leading finally to the appointment as a judge. As there is no unified examination, each court of first instance level recruits its own technical staff among graduates of the Faculty of Law at National University or from Law Schools administered by the Ministry of Justice. If the head of the court thinks it appropriate, he/she recommends the technical staff to be a candidate for an assistant judge and, if he/she is accepted, he/she applies for the unified training program administered by the Supreme Court. After the candidate completes that training course and passes the examination, the Chief Justice of the Supreme Court appoints the candidate as an assistant judge. The provincial or county assembly may promote an assistant judge to the function of judge, if the head of the court thinks it appropriate and applies for the candidate's participation in an examination. If the candidate passes the examination, the Supreme Court, in turn, examines the candidate and if he/she passes that test, the National Assembly appoints the candidate as a judge. It is recognized that there is room for improvement of the process of qualification as a judge. The salary of a judge is estimated around from US$80 to 100 per month, but is increasing. In addition, there are some allowances including fees for gas, which are not easy to calculate exactly (The Survey 2011).

ADR and Informal Justice

In Laos, the Village Conciliation Board is recognized as the body, which has the authority to resolve disputes among the members of the community. It is based on a traditional dispute resolution system. Since 1997, however, it was restructured by a Ministry of Justice circular and was established in every village in the whole country. Its jurisdiction covers civil cases such as debt, property, domestic troubles, land disputes, and minor criminal cases such as defamation, theft, and minor injury or trespass between relatives. If the conciliation is not successful, the Village Conciliation Board shall advise the parties to bring the case to the court.

The dispute resolution through the Village Conciliation Board can save the cost of the formal justice, it is easy to access and psychologically more acceptable for the parties, and it can also help reduce the caseload of the court.

However, the typical member of a Conciliation Board is neither necessarily a lawyer nor a person with legal education, but has merely gone through a short training for a day or so. As a result, the Board has sometimes accepted cases beyond its jurisdiction for example by granting claims to moneylenders beyond the maximum limit of interest rate as provided by law.

The head of the Conciliation Board should be the most influential person within the community and should have a good understanding of the basic policies and laws of the nation. Behind this, it is said that there is the intention of the Communist Party to prevent the harmful effects to the nation from the rapid introduction of the market economy. The government expects the Village Conciliation Board to settle disputes out-of-court and has a policy of promoting conflict avoidance within villages by recognizing a conflict-free village as a "beautiful" village and giving a reward. This policy may influence the perception of the villagers about which kind of conflict should be pursued as a legal matter, and which not. In this context, the problem of keeping a balance between the stability and peaceful order of the society on the one hand and the protection and implementation of the rights of the individual on the other seems to be quite difficult to resolve.

Lawyers and Bar Association

Lawyers

The number of lawyers was 144 as of 11 November 2011 including 17 candidates who were taking the training course, i.e. 2.3 lawyers per 100,000 inhabitants, a low ratio even if compared to other Indochinese countries such as 7.4 lawyers in Vietnam and 4.2 lawyers in Cambodia (see Table 9.1). In order to become a lawyer, one must graduate from a law school (or equivalent) with a bachelor of law, take a 6 weeks' training course provided by the Lao Bar Association (LBA), and complete a 1-year apprenticeship at the LBA. Thereupon the LBA will consider whether the candidate is qualified for law practice or not. If the candidate is considered qualified, the LBA shall send his/her name to the Minister of Justice and the

Minister issues the lawyer's license. Once qualified, the candidate must register with the LBA in order to be able to practice as a lawyer. The registration fee amounted to around US$125 per year as of 2011.

The lawyer's fees are determined by negotiation with the client. There is no regulation of lawyers' fees and contingent fees may be agreed. If the lawyer's fee is fixed by the amount of claim, it will be around 10–20 %. If it is a US$1,200 claim of repayment, and the plaintiff wins the case, the lawyer's fee will be around US$120–240 (The Survey 2011).

However, most people do not consult a lawyer when they are involved in a conflict. Neither the ordinary citizens nor the government understand the role of lawyers adequately. As the representation in court is not limited to lawyers, a relative or an organization of which the plaintiff is a member often becomes his/her representative.

Bar Association

The LBA was established by a Prime Minister's ordinance in accordance with the socio-economic development plan and is placed under the supervision of the Minister of Justice. The LBA's activities include the training of candidates for law practice and paralegals, continuous education for lawyers, legal aid programs, the dissemination of laws, etc.

Legal Aid

A legal aid program was launched in 2003 by the UNDP's project "Enhancing Access to Justice through the Lao Bar Association" and a Legal Aid Clinic was established in Vientiane in 2007. The project has been continued through the support of the Asia Foundation, and the LBA opened a Legal Aid Clinic in Pakse (Southern Laos) and Oudomxay (Northern Laos). The LBA is preparing for a mobile legal aid clinic with the support of the Asia Foundation (Asia Foundation 2007). The Legal Aid Clinic provides free legal consultation, free legal representation for those who need legal aid, and helps with the dissemination of laws. It has opened a legal aid hotline linked with the TV program. The activities of the Legal Clinics are supported by the UNDP and the Asia Foundation.

9.3.2.4 Agenda for Future Development

The Comprehensive Reform of the Justice System to Be Continued

The Lao legal system has developed gradually in accordance with economic growth and social change and with the change of the governance system. It is necessary to continue this type of comprehensive and step-by-step law reform including the codification projects, the empowerment of legal professions by improving their

qualifications, and the empowerment of ordinary citizens through the dissemination of laws and legal clinics. Laos seems to have proceeded incrementally in its own way of legal development.

The gap between formal justice and informal justice As the problems of the Village Conciliation Board show, the gap between informal and formal justice may be partly filled by extending the substantive rules. In this context, legal information should be systematized, consistent, simple, and thus available to as many people as possible.

Promotion of Access to Justice in Rural and Remote Areas

There is also a big difference in legal services between the urban areas and rural and remote areas, where language may be a problem. In order to involve those areas in the national justice system, better, and more frequent communication about the system of law is required.

9.3.3 Cambodia

9.3.3.1 Overview of the State

In 2011, population of the Kingdom of Cambodia was estimated to be around 15,100,000 people in a land area of 181,000 km^2. It has a history quite different from both Vietnam and Laos. The GDP per capita was estimated to be around US $900 for 2011. The growth rate was 6.7 % in 2008, −2.0 % in 2009, 5.96 % in 2010 and 6.09 in 2011 %. Cambodia joined ASEAN in 1999. It has been pursuing comprehensive legal and judicial reform.

9.3.3.2 Legal Reform

Under the regime led by Pol Pot, the legal profession was totally purged. After the comprehensive peace settlement in 1991, the United Nations Transitional Authority in Cambodia (UNTAC) began the legal reform. It was quite difficult for the Cambodian government to draft major laws. As a result, the government asked and accepted comprehensive legal assistance from many donors. This situation was different from that of Vietnam and Laos. The Asian Development Bank (ADB) and the World Bank (WB) supported the Land Law, the JICA supported the Civil Code, the Civil Procedure Law and its ancillary laws, the Canadian International Development Agency (CIDA) supported the Law on Commercial Tribunals, etc. The basic feature of the emerging Cambodian legal system can be characterized as a civil law system. However, as the different donors supported legislation in various fields of law in a shorter period of time without enough information sharing, some

rules were in contradiction with others such as between the Civil Code on the one hand and the Land Law and the Secured Transaction Law on the other, between the Civil Procedure Law and the Law on Commercial Tribunals, etc. It took time to resolve and coordinate these contradictions. As a result, the Civil Procedure Law, the draft of which had been completed in 2003, was promulgated only in July 2006 and came into effect in July 2007, and the Civil Code, the draft of which was completed in 2003, was promulgated in December 2007 and came into effect in December 2011.

After creating this major legislation, the main focus of legal assistance has been gradually transformed from the support of the legislative process to the practical application of those laws by the legal professions and their dissemination to the general public.

9.3.3.3 The Justice System

The Judiciary

The Courts and Civil Procedure

The number of members of legal professions in Cambodia is quite small relative to the population. When the United Nations Transitional Authority in Cambodia (UNTAC) was established in 1992, the number of legal professionals was said to be less than 10. It has increased since then and reached about 50 judges, 100 prosecutors and 38 lawyers in 1995. In 2002, the Royal School for Judges and Prosecutors (RSJP) was established, but as it lacked teachers and materials, the JICA launched a new project for the improvement of legal education in 2005. The Lawyers Training Center (LTC) was established in 2002 with the support of the Bar Associations of the United States, Canada and Japan. As a result, the number of lawyers increased in a relatively short period of time.

In 2011, the number of judges rose to 224, that of prosecutors to 108, and that of lawyers to 754 (JFBA and JICA 2011, p. 2). According to a survey arranged and conducted by the author in cooperation with Ms. Ayako Tamiya, lawyer and JICA expert in Phnom Penh in January 2012 (cited as The Survey 2012 hereafter), the number of judges increased to 271 and that of prosecutors to 144 including judges and prosecutors working in the Ministry of Justice and the RSJP as of September 2011.

The number of courts is very small in Cambodia. There are 23 first instance courts, one appellate court, which is located within the site of the Ministry of Justice, and a Supreme Court.

As a result, the court is still “remote” in the consciousness of the ordinary people. A survey was conducted by the Cambodia Office of the UNHCR based on interviews with 250 inhabitants who resided in the metropolitan area and the rural area in its suburbs in January and February 2000 about how they would resolve the conflicts of civil matters such as land disputes, money lending, etc.

(UNCOHCHR 2002). Only 3 % of the interviewees answered that they would bring the case to the court at the outset, while 85 % answered that they would consult with the head of the village or the county. The reasons were that they did not know the courts existed (39 %), and they assumed the courts would work to control the inhabitants rather than protect their rights (61 %). Further, 58 % of the interviewees who knew of the courts answered that they did not trust the courts because of corruption (68 %) or unfair treatment (23 %). This survey implies that the lack of awareness and confidence would prevent the use of formal justice. As for the court fees, if the claim is repayment of a debt which amounts to US$1,300, then the court fee is US$13, and the fee for appeal to the Appellate Court is one and half times and for the Supreme Court it is twice that in the first instance (The Survey 2012).

In Cambodia as in the other two Indochinese countries, the civil procedure is characterized by the ex officio roles of the court and the prosecutors. As a functional background to this, one may consider the small number of lawyers and the limited ability of the parties to collect evidence, which may in turn restrain parties in launching a civil procedure. Without the ex officio initiative of judges and prosecutors, private parties might be unfairly disadvantaged.

Thus, if the court cannot decide the case with the evidence provided by the parties, it is authorized to investigate for evidence on its own initiative (Art. 124, Para. 2 Civil Procedure Code). In addition, before the trial, the court can examine the documentary evidence and arrange the issues in the preparatory proceeding for oral argument (Art. 104, 106 Civil Procedure Code).

The prosecutor is authorized to participate in the civil procedure and make a statement when he/she thinks it necessary for the public interest. The court has to notify the prosecutor that the complaint was accepted, if it is necessary for the public interest (Art. 6, Para. 1, 2 Civil Procedure Code). However, the parties are guaranteed to attend the examination of evidence, and the hearing of a witness must be held at the date of oral argument (Art. 128, Para. 1; Art. 136 Civil Procedure Code). Even if the defendant does not attend the first preparatory proceedings, the court must set the date of oral argument, and if the defendant does not attend the oral argument, the court can assume that the defendant admitted all statements made by the plaintiff and pass judgment (Art. 201 Civil Procedure Code).

These settings of civil procedure imply that the court is expected to find the truth and solve the conflict correctly rather than to make a decision on the evidence submitted by the parties. However, there are problems in practice as mentioned below.

Judges

Since the establishment of RSJP in 2003, to become a judge, one must graduate from the RSJP, where 8 months courses of lectures, 12 months practical training and 4 months specialized lectures for judges or prosecutors (2 years in total) are provided, and students have to pass the final examinations. As far as the entrance examination of RSJP is concerned, there is an allowance of five students recommended by the government, and a candidate who is a public official may

have the advantage of obtaining an additional 10 % to their score. After that, the candidates draw lots to decide whether they become a judge or prosecutor (lottery scheme). It seems that the appointment process of the judge is unclear, recruitment remains unfair, and corruption is serious even within the judiciary (JFBA and JICA 2011, p. 14). The salary of a judge is estimated at around US$250–400 per month (The Survey 2012). The enforcement of judgments is also problematic, which affects the citizens' confidence in the law as well as in the judiciary (JFBA and JICA 2011, p. 14).

ADR and Informal Justice

It is noted that traditionally the people have tended to consult with the head of village or county when they were involved in a conflict. However, the current situation of the traditional village community needs more detailed analysis.

Lawyers and Bar Association

Lawyers

In order to be qualified as a lawyer, one must major in law at the university, and after this, he/she has to pass an entrance examination of the Lawyers Training Center (LTC) and complete the 12 month study program and a 12-months practical training in a law office, then register at the BAKC (Bar Association of the Kingdom of Cambodia), and thus acquire the certificate from the BAKC.

Also, a former judge who has more than 5 years experiences, or a former judge who holds a quasi bachelor of law and has worked as a judge for more than 2 years, etc. are also qualified as lawyers. But even in these cases, the candidate must complete the 12-month practical training in a law office before the registration at the BAKC. However, the fairness is sometimes questioned between the different qualification processes (JFBA and JICA 2011, p. 15). Problems concerning lawyers include an unequal distribution of lawyers, corruption linked with the judge, unfair trial and judgment, etc., all of which affect their sense of responsibility and undermine the confidence of law-abiding citizens in the system (JFBA and JICA 2011, p. 14).

Bar Association

The BAKC was established in 1995 on the basis of the Bar Association Law and is recognized as independent of the legislature, executive, and judiciary. It is indeed an autonomous organization managed by a board of trustees (Art. 19, Art. 13 Bar Association Law). With this institutional setting the BAKC stands out as the most independent of the three Indochinese bar associations considered in this chapter.

It is not subject to any management or supervision by the Ministry of Justice like the VBA in Vietnam and LBA in Laos.

The registration as a member of the BAKC is compulsory for lawyers. The amount of the fee is about US$10 per month, and the annual income of the BAKC is around US$81,960.

The BAKC provides seminars for its members, legal aid for the poor, disadvantaged, and disabled, as well as the dissemination of legal knowledge through newsletters, etc.

Legal Aid

In 1994, a voluntary group established a first legal aid organization. This organization was succeeded by the Bar Association of the Kingdom of Cambodia (BAKC), which organized its own Legal Aid Department in 1996. It is supported by many donors and provides legal aid for poor defendants in criminal cases, legal representation for women and children involved in civil and criminal cases, etc. Further, there are several other legal aid organizations for the poor, which include the Cambodia Defender Project (CDP, established in 1994), the Legal Aid of Cambodia (LAC, established in 1995), which supports criminal defendants, victims of domestic violence and human trafficking, etc. The LAC also provides legal support for those who are displaced from their homes as a result of land disputes.

9.3.3.4 Agenda for Future Development

Tackling Corruption Among Legal Professions

One of the most serious problems for legal development in Cambodia is the rampant corruption in legal professions. It is not an isolated problem, but part of an amalgam of many problems, which cannot be solved by the legal system alone. They must be tackled as part of a broader governance reform. From this viewpoint, a series of governance reform policies including a salary increase together with stricter qualification requirements and severer sanctions are indispensible. However, increases in salaries cannot be treated only within the framework of legal reforms, but require economic reforms promoting efficiency and thereby economic activity on the one hand, and a reform of taxation and its enforcement by strong government departments, on the other. One more important element to be mentioned in the governance structure is the strengthening of civil society, which can identify any abuse by the government. One of the fundamental conditions of the empowerment of civil society is the increase of general knowledge and understanding of law among ordinary people. This relates to the second agendum of reducing the gap between formal law and legal practice.

Overcoming the Gap Between the Advanced Formal Law and Legal Practice

The gap between formal law and de facto legal practice seems larger in Cambodia than in Vietnam and Laos, because the enacted formal laws are generally comprehensive, detailed, and advanced like those of donor countries, but the density of legal professions is low and their ability to manage these new rules is not yet developed. Under these circumstances (corruption and low density), any perceived abuse of the legitimate power vested in the legal professions generates radical and physical reactions from the victims, affects the citizens' confidence in the law, keeps the gap between formal law and legal practice open and thus leads to the vicious circle described earlier.

A key to breaking this vicious circle seems to be the "nationalization" of formal laws. The major content of formal laws needs to be disseminated not only among the legal professions, but also among the ordinary people so that the formal laws can become the "property" of the Cambodian citizens. This is a challenge, but a worthy one to take up.

9.4 An Integrated Approach to the Promotion of Access to Justice as a Part of Governance Reform

9.4.1 Determinants of Access to Justice

According to the UNDP's survey conducted in Vietnam in 2003 (UNDP 2004, p. 13), elements which influence, facilitate or prevent access to justice are: the honesty and fairness of judges and state officials (74 %), the clarity of laws and regulations (65 %), the existence of good lawyers (31 %), the pressure of media (20 %), the costs of using judicial procedures (16 %), the easy contact with the government (15 %), the existence of assistance from associations (8 %). The reasons for the lowest propensity to go to court include: the fear of losing face if the party does not win (41 %), negative repercussions on the social environment even with a favorable court decision, such as derisive reactions, bad feelings, etc. (36 %). These results show that the costs civil procedures and a lack of legal assistance are not the first or decisive factors to prevent access to justice, though they do influence a decision of whether or not to go to court. The determinants of such a decision are neither single, nor simple, but comprehensive and complex. The parties involved are very much concerned with the total resolution of the conflict taking into consideration the results in a broader informal social context even after winning the case in a formal civil procedure. Thus the most important consideration is whether justice is done in the end.

On the basis of this analysis, the possible determinants of access to justice may be restated on the following three levels of analysis:

9.4.1.1 Determinants on the Level of Legal Rules

1) comprehensiveness and consistency of the formal laws

9.4.1.2 Determinants on the Level of Legal Institutions and Legal Professions

2) number of courts and their accessibility,
3) number of judges and court officials,
4) ability and experience of legal professions to work within the formal justice,
5) time and cost required to use formal justice,
6) variety of ADR available in accordance with the needs of conflicting parties and their accessibility,
7) legal aid intermediating citizens' access to the formal justice system, the number of access points and accessibility,
8) function of the community to solve the conflicts between its members and the adequacy of the results,

9.4.1.3 Determinants on the Citizens' Level

9) knowledge and understanding of the legal system of the state including formal laws, and the judicial system which applies them, as well as of ADR, and of informal justice (the widespread information about legal system),
10) confidence of the citizens in the legal system,
11) expectation of the citizens of the legal system (a judge's simple decision of the relative merits of the party's claim or a search for the truth and a correct resolution of the conflict),
12) awareness of citizens about what the legal problem is.

These determinants are interrelated. For instance, the ability and experience of legal professions (4) and the confidence of the citizens in the legal system (10) would correlate, and they are also closely related with the number of courts and their accessibility (2) and the number of judges and court officials (3). However, they may be hard to achieve simultaneously in the early stages of judicial reform, because, if the government increased the number in the legal professions over a short period, it would be difficult to also enhance the capabilities of those legal professions in a short time frame. There seems to be a trade-off between the rapid increase in the number of those in the legal professions and the strengthening of their capabilities. If the government implements the policy to rapidly increase the number of legal practitioners at the expense of quality, it would stimulate a cycle of rent seeking, increased corruption and affect the confidence of the citizens in the rule of law.

In Cambodia, many donors have assisted in creating legislation so that the formal laws seem to be superior to those of Vietnam and Laos. However, Cambodia

faces many problems in determinants 2–10 above. Determinant 4 is difficult to ascertain because of the lack of unified data.

In Laos, on the contrary, the government has used a trial and error approach to create a piecemeal legislation in accordance with the changes of its economy and society, and is now on the way to compiling a comprehensive civil code. It has still problems concerning elements 2–8, especially the dissemination of formal rules that are crucial topics, such as the legal provision on the ceiling of interest or on the jurisdiction of the Village Conciliation Board.

In Vietnam, elements 1–4 seem to have improved, though there is still room for further improvement, and even more so concerning elements 5–7. Additionally, as far as the element 8 is concerned, it is necessary to analyze and evaluate carefully how the Communist Party's policies influence the community-based dispute resolution, and what kind of control they actually exert. This is the characteristic governance method of former "East Bloc" countries to control the process of the introduction of market mechanism into a socialist country experiencing a radical change of its social structure. In Vietnam and Laos, even the legal aid center (clinic) is incorporated or linked with, the government administration.

Thus the current state of access to justice is different within each of the Indochinese countries, due to different combinations of the above listed determinants. But some similarities and common features can be found in the evolution of access to justice in these countries. The civil procedure systems in these countries are more or less based on the principle of *ex officio* initiatives by the courts and prosecutors. To be sure, the powers and responsibilities of the judge (court) and those of the prosecutor office are not identical, and the power of prosecutors in civil procedures fluctuates in reaction to the incremental movement toward judicial independence. However, behind this principle, traditional elements seem to persist which are fundamental to the *ex officio* principle and are deeply rooted in the consciousness of the people. It is the expectation of the people that the government finds the truth and resolves conflicts in their totality, not abandoning them simply to the court decision about the relative merits of the claim between the parties. Of course, such an expectation may not have existed a priori but may have gradually been created by the governance structure which lasted a very long time, and in which the strict long standing rules with severe punishments against any deviation disciplined the nation and fostered the now routine dependence of the nation's people on the government.

One more common feature found in Indochinese countries is the significant role of the community in dispute resolution. In the community, people seem to be not only familiar with the head of the community but feel obligated to the community for their life and existence. In this context, when a member of the community is involved in a conflict, he/she will wonder whether litigation is a good thing or a bad thing, and how he/she can identify if a conflict is a "legal" one or not.

These common tendencies are not immutable, however. Assuming such attitudes as fixed determinants would imply that it would be useless to seek any progress towards absolute standards of the rule of law. Unmistakably, the direction and the

process of change toward the increasing access to justice seem to have opened up at least somewhat.

9.4.2 *An Integrated Approach as a Basic Policy for the Promotion of Access to Justice*

The prescription for promoting access to justice depends on the context of each country. However, one conclusion, which may be commonly confirmed from the three Indochinese cases, is that access to justice may be more effectively promoted by an integrated approach which combines continuous, comprehensive and consistent legal reform, ongoing training for the legal professions, and continuous interaction with civil society (see Fig. 9.1). Since these three aspects are deeply related, they should be promoted simultaneously even though each project may be small in scale. Projects facing difficulties should be undertaken step-by-step, incrementally, moving slowly to the desired objective. This strategy may be part of the promotion of the rule of law, which is based on a multi-layered, process oriented and dynamic concept of the rule of law and its promotion through legal cooperation (see Matsuo 2009).

For instance, the legal empowerment not only for the legal professions but also for the citizens cannot become effective if it is not combined with the provision of knowledge of current laws by using concrete situations such as the limits of interest rate, jurisdiction of conciliation, etc. Along with this, explanations of the reasons for particular prescriptions of the law, executive order or judicial decision are necessary. Even with legal aid, the poor, the handicapped, the disadvantaged people should not be considered as objects of assistance but as subjects of the justice system reform. So they should be acquainted not only with the results of dispute resolution, but also with current laws and the reasoning behind them. If this (triangle) schema is effectively combined within a particular project in a given country, "the space" of access to justice will gradually enlarge moving towards a ubiquitous system, which can be measured and evaluated by a three-dimensional figure (see Fig. 9.2).

The integrated promotion of access to justice has already partly begun with some projects in these three Indochinese countries. For instance, in its phase 2 the JICA project of legal assistance to Vietnam has been divided into two sub-projects, one assisting legislation in civil and commercial fields (sub-project A) and the other focusing on the empowerment of legal professions such as judges (documentation of judgments), prosecutors (manuals of investigation) and law enforcement officials (enforcement of judgments) (sub-project B), and they have been proposed and promoted simultaneously (JICA 2009, pp. 23–31). The project for empowerment of the VBA and the strengthening of the implementation and enforcement of law has been undertaken by UNDP. The legal reform and legal education programs are also supported by many donors such as the USAID, SIDA, AusAID, etc.

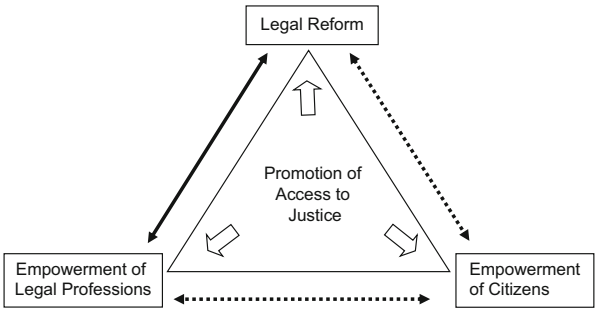

Fig. 9.1 An integrated approach to access to justice

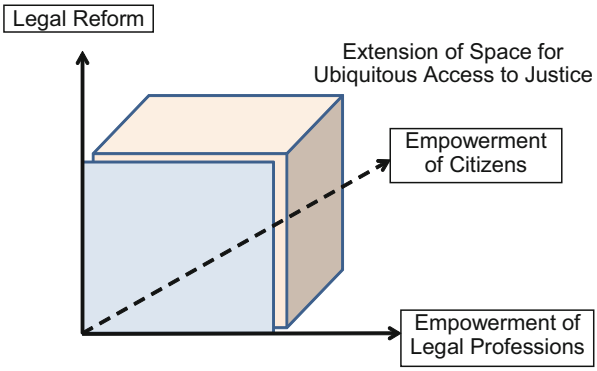

Fig. 9.2 A three-dimensional figure of access to justice

In Cambodia, the legal assistance project for drafting the Civil Code and the Civil Procedure Code has been combined with a project assisting the RSJP in legal education for judges and prosecutors, as well as with the project to establish the LTC. The latter project was jointly supported by the Bar Associations of the U.S., Canada and Japan. However, the empowerment of citizens has not proceeded as well compared to the combination of the legal reform and the empowerment of legal professions. Its linking with the legal reforms and the empowerment of the legal professions has turned out to be much more difficult. The key to the link is how to translate the huge body of complex legal rules together with the legislative reasoning into plain language understandable by the general public.

It seems that this problem is considered very seriously by Vietnam, Laos and Cambodia, where the governments are trying to disseminate knowledge of the formal laws among the citizens as well as the legal professions. In this context, it is interesting to note that the formal legal systems in these countries seem to be turning more and more into the civil law approach. The civil law system may have advantages in describing the rules in a systematic way, and should be recognized as a tool to improve the governance structure of the state. The earlier the stage of development of a country is, the greater the advantage of the civil law system. This is not to deny the fact that there are various types of civil law systems and some of them are mixed with common law elements. The civil law system can be adopted by

legislators as a useful tool to achieve a comprehensive legal reform of the state within a limited period of time without having to wait for the emergence of judge-made law over centuries as with English common law. Civil law codes are compiled and published in a book, which can be used by students and teachers as material for legal education, by legal practitioners for reference, and by businesses as well as the general public. A similar usage of the civil law can be found in South Korea, Taiwan and Japan. Civil law thus supplies a link uniting the various groups in a society. In countries where citizens have little legal savoir-faire, civil law can be a firm foundation for their legal empowerment.

If this is true, the inspiration of legal reforms by the civil law system may be a key to further promoting access to justice in Indochinese countries.

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Chapter 10
Access to Justice in Central Asian Countries

Hans-Joachim Schramm

10.1 Some Preliminary Remarks

When presenting the results of a study on access to justice in the five Central Asian Countries (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) some preliminary remarks are useful.

First, it seems necessary to distinguish between access to justice in a more formal sense from access to justice in a material sense. While access to courts in a formal sense, that is, the possibility to file a lawsuit before an independent state body, is an indispensable condition for material justice, it is not a sufficient one. Access to justice in a materiel sense is reached when conflict solution by a court is regarded as 'fair' and 'effective'. Corresponding World Bank studies refer to the categories of 'an affordable access to courts', a 'quick procedure', 'a fair judgment' and 'the ability to enforce a court decision' (Anderson et al. 2005, 2007; Deppe 2008). A methodological problem lies in the fact that these studies are based on questionnaires, reflecting subjective impressions of being treated fairly or not.

This chapter concentrates on access to justice in a more formal sense allowing only very cautious conclusions on access to material justice.

Second, it has to be pointed out, that empirical data with regard to Central Asian Countries is scarce. The main sources in this respect are legal provision relevant to the topic. Other data from the countries themselves, especially statistics with regard to the number of courts, density of conflict resolution through the courts or payment of judges, are hard to find. In this respect, the lack of transparency is still an issue. Kazakhstan seems to be the frontrunner as regards openness and has started some sociological studies to monitor the judiciary (Bulletin of the Supreme Court of the Republic of Kazakhstan 2011, 1, p. 90 ss). However, since interviewees still answer quite unanimously 'yes' to questions relating to their satisfaction with the court

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system, officially published results must be taken with care. So basic sources still come from Western institutions like the World Bank (Anderson et al. 2005, 2007) and the German Agency for International Cooperation (former GTZ, now GIZ) (Knieper et al. 2010).

Third, when doing research on the judiciary in Central Asian countries, history and geographic situation should never be forgotten. These countries were annexed to the then Tsarist Empire at the end of the nineteenth century. Only at this time were state courts formally distinct from the established government. Up to then local courts were in place, presided by the 'eldest' and most respected person, judging according to local customs. Nowadays in some countries of the region discussions are under way as to what degree these old traditions should be revived, e.g. under the name of '*Biiv* Courts' in Kazakhstan.

During the Soviet Period a court system was established which formally was comparable to courts in western democracies. However these courts had a totally different function as soon as 'public interests were at stake'. The primary tasks of soviet courts were not to resolve conflicts between private citizens, but to guarantee the predominance of ruling Communist Party. At the end of the day, courts were part of the public administration, a legacy the so-called third power is still suffering from in all countries of the region.

10.2 Legal Framework for an Access to Justice

After gaining independence with the collapse of the Soviet Union in 1991, all Central Asian Countries have committed themselves to establish the rule of law in their countries and have adopted constitutions ranking legal provisions at the top. These documents do contain chapters on fundamental rights including the right to address a court to protect one's rights (Constitution of the Republic of Kazakhstan 1995; Constitution of the Kyrgyz Republic 2010; Constitution of Tajikistan 1994; Constitution of Turkmenistan 1992; Constitution of Republic of Uzbekistan 1992). Such a provision includes the duty of the state to establish a functioning judiciary. Correspondingly all constitutions further include particular chapters on the court system (Constitution Kazakhstan 1995; Constitution Kyrgyz Republic 2010; Constitution Tajikistan of 1994; Constitution of Turkmenistan of May 18th, 1992; Art. 106–116 Constitution of Republic of Uzbekistan 1992). Here basic rules are laid down concerning the principle of independence of the judiciary and the principle of *zakonnost*, meaning that judges are bound by the law. So the overarching question, how to "find" or "make" the law, i.e. any unwritten law, has been decided at the highest level. Courts have to interpret the codified law, not to create it. Civil codes do provide for rules on what to do in case the law does not provide an answer to a particular question. But here again, judges are not free to create the law but are bound by the general principles and intentions expressed by the lawmakers.

In addition these chapters contain provisions on the different branches of the court system (civil courts, specialized economic courts, administrative courts) including the setting up of a Constitutional Court. This is relevant with regard to

access to justice since the distinction between different branches may either materially ease the way to justice, especially when civil courts and administrative courts are separated, or on the other hand, it may impede access to justice if branches are established on the basis of inappropriate criteria.

The question deserves attention whether specialized Constitutional Courts are in place in these countries offering a kind of 'last resort to justice' in cases when ordinary courts have not ***properly protected*** fundamental rights. This concept however has only been partially implemented in these countries. In Kazakhstan, Constitutional Council has been established reflecting the French concept of a Conseil Constitutionnel. In the Kyrgyz Republic, a specialized chamber of the Supreme Court has jurisdiction over constitutional cases. Constitutional Courts in a narrow sense do exist in Tajikistan and Uzbekistan. So except for Turkmenistan, all countries in the region accept the concept of constitutional courts. However, individual claims by citizens before the courts are not yet permitted. So in the end, Constitutional Courts have not as yet given citizens access to their services in these countries.

Having their roots in the Soviet Court system, differences with regard to the court system become understandable. For that reason in Uzbekistan and Tajikistan the civil jurisdiction is still divided between economic matters and civil matters, each category having their own courts and procedural rules. Thus it may happen, that identical legal issues are brought before different courts depending on the status of the parties. Specialized 'administrative' courts that grant legal protection against actions of the state and its functionaries are (the courts) another topic, which is on the reform agenda. Although most countries have adopted laws on administrative procedure (laws on administrative procedures can be found in Kazakhstan, law of November 27th, 2000, Kyrgyzstan, law of March 1st, 2004, and Tajikistan, law of March 5th, 2007), the understanding of the particularities of administrative court procedure is only at an embryonic stage.

10.3 Main Results of the Study

In the following section, the main findings of the research on access to justice in Central Asian Countries will be presented. A central element, demonstrated and worth noting, is that all countries follow the continental European tradition of law-bound judges deciding cases on the basis of codes. This concept is identical in all the countries of Central Asia because they have been and still are strongly influenced by Russian legal tradition, while Russia has always been inclined to continental European law. In most countries new Civil and Civil Procedure Codes have been adopted, which are more or less similar depending on the influence of western, especially German consultants.

In this context it deserves to be noted that the concept of 'precedents' is now discussed in these countries. However the concept is—voluntarily or not—widely misunderstood by its protagonists. In these countries the idea of a 'precedent' is held up to prove the binding force of Supreme Court decisions for lower courts.

Table 10.1 Basic rules and structures of civil procedures

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
1. "*Jura novit curia*" *rule as a public good* ("*The court knows the law*", *there is no burden of proof for parties on questions of law*)	Yes	Yes	Yes	Yes	Yes
2. *Judges as* "*referees*" *in trial dominated by lawyers* (*may take expert testimony on questions of law*)	No	No	No	No	No
3. *Judges applying Codes*	Yes	Yes	Yes	Yes	Yes
4. *Judges* "*finding the* (*unwritten*) *law*"	No	No	No	No	No
5. *Written procedure*	Yes	Yes	Yes	Yes	Yes
6. *Oral hearings*	Yes	Yes	Yes	Yes	Yes
7. *Court controlling pace of procedure*	Yes	Yes	Yes	Yes	Yes
8. *Lawyers controlling pace of procedure*	No	No	No	No	No
9. *Court identifying relevant facts*	Yes	Yes	Yes	Yes	Yes
10. *Lawyers engaging in pre-trial discovery*	No	No	No	No	No
11. *Lawyers in unified role of advice and representation in court*	No	No	No	No	No
12. *Two-tier structure of solicitors and barristers*	No	No	No	No	No
13. *Class action admitted*	No	No	No	No	No

(continued)

Table 10.1 (continued)

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
14. *Summary debt procedures institutionalized*	Yes	No	No	No	No
15. *Default judgment routine procedure*	Discretionary	Discretionary	Discretionary	Discretionary	Discretionary

Sources: Table design: Louvain Questionnaire Table I, Schmiegelow and Schmiegelow (2011); author's own data

In other words it is meant to give an authoritative force of interpretation to the high court judges. This idea is understandable to a certain extent, given the problem of the poor quality of lower judges. However, it is by no means inconsistent with the aim of bringing on a new generation of independent judges.

Starting from this finding it is not surprising that answers in the first table of the Louvain Questionnaire on Rules and Structures of Civil Procedure Affecting Access to Justice as Cost and Time Factors (Schmiegelow and Schmiegelow 2011) on basic rules and structures of civil procedure are more or less identical in the five Central Asian countries (Table 10.1).

Judges in all countries decide according to the law and they are the masters of the procedure. Lawyers have only a minor role in the search for justice, which has its origins in former soviet times. In fact the leading role of judges determining the pace of the procedure sometimes violates the principle of the autonomy of the parties, at least in civil law cases. And lawyers are not always respected as equal partners with the judge, which is especially problematic in criminal cases.

The questionnaire does not make reference to public notaries who are not a factor of access to formal justice since they are not concerned with civil procedure nor with the resolution of conflicts. However with regard to 'material justice' notaries should be taken into consideration with respect to their function of avoiding conflicts. At this stage a discussion on their appropriate role within the legal systems of the relevant countries is under way opposing those who prefer 'the affordability of transactions' to those who recommend 'secure transactions'.

With regard to concrete procedural topics, it has to be pointed out that civil procedure codes in these countries are still under construction. The most developed one can be found in Kazakhstan. But even here, class actions, which have only recently been introduced into Russian law, have not made their way to Central Asia yet. However in this context it has to be noted that the absence of such a procedural concept may not be a problem since it can be replaced by other means, e.g. a right to file a lawsuit may be vested in a state body such as a security commission or a consumer protection organization. Compared to Kazakh law, such regulations do exist in other countries, apart from Turkmenistan, but still need to be improved. Specialized provisions allowing a quick recovery of debts via a summary procedure have been enacted, but may still be improved.

Table 10.2 Out-of-court settlements and alternative dispute resolution (ADR)

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
1. *Arbitration*	Yes	Yes	Yes	No	Yes
2. *Mandatory or court-supervised conciliation procedures*	No	No	No	No	No
3. "*Justice in many rooms*" (*Galanter*)					
3.a. **"** *In the shadow of the law*"					
3.b. *Following local traditions*	'Biev courts'	'Aksakalov Courts'			

Sources: Table design: Louvain Questionnaire Table II, Schmiegelow and Schmiegelow (2011); author's own data

As to the second part of the Louvain questionnaire, it can be stated that all countries, aside from Turkmenistan, have adopted laws on arbitration, thus opening the way to private litigation. However, a law on arbitration does not guarantee functional practicality. The crucial point is, under what conditions decisions of arbitration courts are enforced by state bailiffs. Here several pitfalls exist so that a final assessment of the efficiency of private litigation can only be made after more detailed research. This is also the case for alternative dispute resolution, i.e. justice based on indigenous traditions. This is an issue in Central Asian Countries where local courts, presided by an elder layman, formerly had an important role. Presently, this form of dispute resolution is being revitalized and in some countries where such courts have gained an official status as for example the *Aksakalov* Courts in Kyrgyzstan (Table 10.2).

The status and pay of judges is an issue, which is at the core of judicial reform in these countries. Finally, it can be stated that judges are professionals; they need theoretical and practical legal education before moving into a job where they are appointed, not elected, by other stated bodies. So far in the transformation of Central Asia legal systems similarities to the continental European concept of a judge are evident (Table 10.3). In contrast, judges have been regarded for decades as a part of the executive branch and did not experience personal and material independence under the Soviet Union system. And although these topics are clearly priorities in the Constitutions, in practice the current system is apparently not well suited to guarantee the independence of the judiciary. Here the devil is in the detail: who appoints the judges, for how long, who decides on the assignment of individual cases to a particular judge? These are the topics for discussion in the near future.

Among these topics the question of the level of pay for judges is of preeminent importance. Here again official information is hard to find since figures are not published but can only be found randomly in newspapers. Interestingly though, they are at least made public when they are considered newsworthy. In Kazakhstan the salaries of judges has recently been raised significantly and now reaches a level

Table 10.3 Status and pay of judges

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
1. *Professional judges in public service*	Yes	Yes	Yes	Yes	na Not applicable
2. *Judges selected or elected as "peers"*	Selected	Selected	Selected	Selected	na
3. *Academic training required*	Yes	Yes	Yes	Yes	na
4. *Practical experience required*	Yes	Yes	Yes	Yes	na
5. *Academic plus practical training required*	Yes	Yes	Yes	Yes	na
6. *Yearly salary roughly in line with civil service* *6.a. first instance level* *6.b. appellate level* *6.c. supreme court level*	na	na	na	na	na
7. *Yearly salary significantly higher than civil service* *7.a. first instance level* *7.b. appellate level* *7.c. supreme court level*	a. US $1,375 b. na c. US $3,100[a]	na	c. app US $750[b]	na	na
8. *Yearly salary significantly lower than civil service* *8.a. first instance level* *8.b. appellate level* *8.c. supreme court level*	na	na	na	na	na

1,800–2,400 Somoni as of January 2011, in September 2011 salaries have been increased by 50 %
Sources: Table design: Louvain Questionnaire Table III, Schmiegelow and Schmiegelow (2011); *Data*: author's own
[a]http://mojazarplata.kz/main/kz-news/obnarodovany-zarplaty-sude-v-kazahstane
[b]http://news.kob.tj/news/8935

which, compared to local standards, is above average, US$1,375 monthly plus fringe benefits for a lower court judge. In Tajikistan figures have been published, which is in itself a progress. However if a Supreme Court Judge gets US$750 per month this shows that the problem of strengthening the 'third power' by making the salary attractive has not yet been resolved (Table 10.3). With respect to other countries no figures are available which is already a bad sign. It is very likely that figures are even lower here. In addition, it can be seen from personal experience that judges are often paid through fringe benefits (apartments, cars, holiday resort vacations), which additionally undermines their independence.

The function of lawyers in these countries is still under-developed. In Soviet times they were accepted but not respected, and at present they find themselves in the role of David fighting the state Goliath. Lucrative mandates from local private

clients are still scarce and foreign investors prefer law firms operating worldwide. For that reason, official information or even the existence of 'lawyers associations,' are not widespread. However, anecdotally, we see that lawyer's fees are often mentioned as being too high to be affordable for less well-off people.

As to their legal status, regulations correspond to that of lawyers on the European continent. They must have specialized education and practical training. It is not a typical business-oriented profession but is considered part of a common service for protecting individual rights. There is no distinction between representation before the court and client consultation. Fees are a contractual issue and contingency fees are not allowed. Although a specific rule in this respect could not be found, an explanatory note on the law in Kazakhstan made clear that contingency fees may not be agreed upon in a contract. It is probably the same in other countries (Table 10.4). Additional information with regard to the importance of advocacy in general is not available.

Most striking differences between countries can be found with regard to the cost of litigation. For example in one type of claim, debt recovery, the starting point is the same everywhere. Court fees are calculated on the basis of the value of the claim. But the method of calculation is different. First, does the fee change correspondingly with the value of the claim, progressively or degressively. On the European continent a degressive calculation seems to be typical, but this is only the case in Tajikistan. In Kyrgyzstan and Uzbekistan fees increase progressively, which makes it prohibitive to start a lawsuit if a lot of money is at stake (Table 10.4). Remarkably percentages also vary in line with different criteria. In Kazakhstan it is cheaper for natural person to go to court than for a legal person. In Uzbekistan SMEs are privileged.

Second, with regard to access to justice the question of legal aid is of utmost importance. In this respect the old concept of fee reduction for a certain group of people or a specific type of claims prevails. Thus advocates are obliged to offer consultation to, advise or represent certain people free of charge and courts are obliged to accept certain claims without charging fees (Table 10.5). In reality this practice reveals real problems since it often leaves less well-off people without legal representation if they have no access to legal aid.

Finally all countries follow the rule that the losing party has to cover all legal representation costs including those of the adversary up to a fixed amount.

When it comes to the topic of the density of the legal structure and the density of litigation, the flow of information is even further reduced (Table 10.6). As a general rule it can be stated that court systems are based on a three-tier structure of local courts, regional courts and one Supreme Court with local courts at locations corresponding to the territorial-administrative structure of the country. So a court building should be within the reach of the citizens taking into account geographical particularities.

Differences may also be seen with regard to the number of judges. While in Kazakhstan there are 13 judges for every 100,000 inhabitants, in Kyrgyzstan there are only 7 and only 4, 5 in Tajikistan. Turkmenistan and Uzbekistan do not publish

Table 10.4 Status and pay of lawyers

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
1. *Legal profession in the service of the law*	Yes	Yes	Yes	Yes	
2. *Legal profession as business*	No	No	No	No	
3. *Academic training required*	Yes	Yes	Yes	Yes	
4. *Practical experience required*	Yes	Yes	Yes	Yes	
5. *Academic plus practical training required*	Yes	Yes	Yes	Yes	
6. *Fees set by law according to descending scale of percentages of value of matter in dispute*	No	No	No	No	
7. *Fees per hour negotiated with client*	Yes	Yes	Yes	Yes	
8. *Contingent fees admitted*	No	No	No	No	
9. *Average contingent fee 40 % or more of proceeds from case*					
10. *Average contingent fee below 40 % of proceeds*					
11. *Share of legal profession in GDP 2 % or more*					
12. *Share of legal profession in GDP below 2 %*					

Sources: Table design: Louvain Questionnaire Table IV, Schmiegelow and Schmiegelow (2011); author's own data

any figures. This finding again highlights the point that legal reform in Kazakhstan is the most advanced in the region.

As to the total number of cases heard, no court data is publicly available. The same is true as to the time required to get a court decision. However it is worth mentioning here that procedure codes provide for specific timeframes for judges obliging them to make a ruling within a certain period, usually somewhere between 2 or 3 months. In practice this leads to negligent wording of court decisions or even worse, if the workload piles up too much for judges, to order to the court's back offices to reject claims for the tiniest error in the formalities.

Table 10.5 Cost rules and structures

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
1. *Loosing party pays*					
1.a*. all court costs*					
1.b. *all court costs and winning party's lawyer's costs*	Yes	Yes	Yes	Yes	Yes
2. *Each party pays its own lawyer's costs*	No	No	No	No	No
3. *Total cost* (*both sides*) *of one claim in absolute numbers* (*court cost plus lawyers' fees*)	1 % for physical person r-esp. 3 % for legal person of the claim's value	Progressive from 5 to 10 % of the claim's value	Degressive from 3 to 0.5 % of the claim's value		Progressive from 5 to 20 %, reduced rates for SME
3.a*. set by law according to descending scale of percentages of value of matter in dispute* (*in* € *or equivalent of* € *in other currencies*):					2.5–5 %
3.a.a*. claim of 1,000* €					
3.a.b*. claim of 10,000* €					
3.a.c. *claim of 100,000* €					
3.b. *estimated average allowing for wide margins of fees negotiated between lawyers and clients*					
3.b.a*. claim of 1,000* €					
3.b.b*. claim of 10,000* €					
*3****.c.c****. claim of 100,000* €					

(continued)

Table 10.5 (continued)

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
4. *In countries allowing self representation for small claims, total cost, if neither party involves lawyers: claim of 1,000* €					
5. *Judge may award winning party reimbursement of its costs as damage*					
6*. Public legal aid* (***counsel or cost assistance***) *available*	Yes	Exemptions from court costs depending on the content of the claim	Exemptions from court costs depending on the content of the claim		Exemptions from court costs depending on the content of the claim
7. *Legal protection insurance available*					

Sources: Table design: Louvain Questionnaire Table IV, Schmiegelow and Schmiegelow (2011); author's own data

10.4 Some Closing Remarks on Remaining Shortcomings and Ongoing Reform Efforts

The topic of judicial reform is still on the agenda in at least some of the countries of the region. In 2009, the Kazakhstan President adopted a new set of proposals regarding legislative policy, which includes a number of proposals to make civil procedures more effective. These proposals aim at easing access to the courts, enforcing the principle of private autonomy and a move to a more controversial, party based, procedure.

In an attempt to raise the credibility of courts and to fight corruption in Kazakhstan a special initiative to 'clean the judiciary of unscrupulous elements' was started, as a consequence of which six judges were expelled from the Supreme Court in April 2011 and criminal procedures initiated against two of them (Supreme Court Kazakhstan 2011). On the Court's website a 'forum' has been opened to discuss current topics of court system reform, including a question on impediments to access to the courts. Complaints refer to, among other things, the poor quality of judges and their dependence upon Court Presidents. For that reason a discussion has been started asking

Table 10.6 Density of legal structures per 100,000 inhabitants

	Countries				
Rules/structures	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
1. *Civil law 1st instance Courts*	App 2 (total 340)	App 1 (total 70)			
2. *Civil law appellate courts*					
3. *Civil law Supreme courts and/or constitutional courts controlling the constitutionality of civil law norms*	Supreme Court & Constitutional Council	Supreme Court & Constitutional Chamber	Supreme Court, High Economic Court, Constitutional Court	Supreme Court	Supreme Court, High Economic Court, Constitutional Court
4. *Civil law judges*	App. 13 (total 2,140)	App 7 (total 374)	App 4.5 (total 350)		
5. *Lawyers*	App. 30 (1 per 3,500 inhabitants)				

Sources: Table design: Louvain Questionnaire Table VI, Schmiegelow and Schmiegelow (2011); author's own data

whether Court Presidents should be elected by the respective judges (nearly 2/3 of votes were in favor of this proposal). Encouraged by a World Bank study (2011), discussions on the need for court reform started also in Kyrgyzstan.

To conclude this chapter, a short overview of remaining shortcomings in the procedural laws in these countries, in addition to the shortcomings previously mentioned, is useful.

1. *Function of state attorneys* (*procuracy*): In Soviet time state attorneys had the overarching function of supervising the legality of actions in all spheres, even among private citizens. As a consequence procurators were entitled to be a party in civil law cases. This legacy has not yet been abolished. On the contrary, the important role of state attorneys has been fixed in most of the Constitutions (Art 85 Constitution Kazakhstan 1995; Art 93–97 Constitution Tajikistan 1994; Art 118–121 Constitution Uzbekistan 1992; Art 110–114 Constitution Turkmenistan 1992).
2. *Corruption and independence of judges*: This topic is at the core of all discussions since public trust in the courts seems to be very low, although reliable data is hard to find. In a recent study from Kazakhstan, 5 % of interviewees answered in the affirmative to a question do they suspect judges of being corrupt (Bulletin Kazakhstan 2011). In Kyrgyzstan on the other hand, public trust in the courts is purported to be below 10 % (Report 2011). Even if the truth is somewhere in between these extremes, this shows that formal access to justice does not mean that users feel they are being treated fairly.
3. *Juries*: As a major instrument to promote transparency and incorruptibility of courts, the further spreading use of juries at least in criminal cases is discussed. Although civil cases are less affected directly, the outcome of this discussion will have repercussions on the perception of the role of a judge in general.
4. *Plea bargaining*: This term is related to a concept in criminal procedure where bargains between the accused and the state attorney are allowed with the purpose of avoiding a (costly) court procedure. Under the auspices of the judge the attorney offers a reduced sentence while the accused confesses guilt. While such deals are widespread in the US and permitted in Germany, they are highly problematic and can ruin the image of the judiciary as an institution.
5. *Legal aid*: The issue of legal aid for people not able to afford a lawyer is not yet resolved.
6. *Financing of Courts*: The dependence of courts on financial support gives the executive branch a serious means of pressure when they decide what portion of the budget is allocated for the justice system from the general budget. In the future, the independence of judges must be guaranteed by a proper level of financial support.

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Constitution of Turkmenistan (May 18th, 1992) Art 99–109;
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Civil Procedure Code	Гражданский процессуальный кодекс Кыргызской Республики от 29 декабря 1999 года №146 (Civil Procedure Code of the Kyrgyz Republic promulgated on 29 December 1999 N° 146)
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Uzbekistan

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Part IV
Legal Cultures and Legal Reforms

Chapter 11
Push and Pull of Judicial Demand and Supply

Erhard Blankenburg and Bert Niemeijer

11.1 Introduction: Dramatic Increase of Legal Action in the Netherlands

In the past 20 years the Netherlands experienced a dramatic increase of litigation cases, particularly in administrative law (for which a two tier court was created as late as 1994), and in labor law after dismissals (which before 1990 were handled by bi-partite commissions before the labor administration). The penal courts also moved to more and longer prison sentences (which catapulted the Netherlands from a country with the lowest prison population of Europe to a high rank just behind the United Kingdom). Observers have seen the dramatic judicial increase as an end of the "pillars of informal control", which had been the trademark of Dutch legal culture. The harsh prison policy has been attributed to a mentality change among the legal profession when the liberal generation of jurists from the years after 1968 was replaced by a new generation of 'no-nonsense' judges. Downes (1988) gave a brilliant analysis of the liberal attitude of Dutch judges explaining the low prison rate, exactly at the time when the *explanandum* vanished. Government financed new prisons and the inmate population began to rise. Apparently, professional as well as political mentalities followed public sentiments resulting in a rapid process of institutional change. But one might just as well point to the generation change among policy makers who streamlined court organizations and introduced what many regard as factory-like productivity controls.

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While such explanations point at changes of procedural legislation and judicial policy, others claim that it was mainly popular expectations increasing pressure on the judicial system. Whichever might have been first, it seems clear that overall mentalities have changed on the supply side of the legal profession as well on the demand side of increased use of formal procedures and strict legality.

The origins of the changes may be found in legislative events, social evolutions and professional changes. The increase has been most spectacular with regard to administrative procedures. The European Court of Human Rights (at Strasbourg) in 1984 had ruled the Dutch Appeal to the Crown (Kroonberoep) as judicially insufficient which obliged the Netherlands to form an administrative bench at the Council of State and in 1994 introduce a full fledged two tier administrative court. The complex regulations of the welfare state and particularly the restrictive immigration policy generated waves of mass litigation. Dismissals at work, which had been handled traditionally by tri-partite commissions, was taken more and more often to the regular courts because of changed conditions in the labor market, particularly the increase of short-term labor contracts. And the civil litigation increase may partly be attributed to increasing European competition, which broke up the patterns of arbitration and internal conflict management that had been the trademark of Dutch patterns of business.

In a sweeping generalization we might attribute the changing litigation patterns partly to the installation of new courts and procedures (on the supply side), partly to increased demand given new social problems. On the side of the infrastructure (supply side) some of the arbitration bodies lost legitimacy (and thus caseload), others (such as court related mediation) were fostered by courts and legislation. The Dutch courts also continued traditional summary procedures such as the '*kort geding*' (provisionally enforceable relief) and the simplified divorce procedures.

Nevertheless, so-called "legal needs" research into the ways in which potentially legal problems are handled, could demonstrate that the potential of legally relevant conflicts might continue to hold back much higher judicial caseloads. With everyday problems, people remain reluctant to invoke judicial procedures, and once they start them, they more often end up settling cases before they reach the stage of final court decisions. This holds true for conflicts which people experience in their private lives as well in business practices and procedural law. Additionally, the practice of courts in the Netherlands is to stimulate conflict prevention and mediation, in spite of (and in my opinion also with the help of) a (still comparatively) generous public subsidy for the legal aid infrastructure.

Here I shall only report some of the data of a Dutch survey on the litigation behavior of a representative sample of Dutch households, which (with some difference in the details) fits the patterns, which we find in comparative surveys in Great Britain and even Japan (Sect. 11.2). I shall then present some indicator comparisons for European countries, particularly comparing Western Europe to some of the post-communist European member countries (Sect. 11.3). And finally I shall put this data in the context of budget comparisons (Sect. 11.4).

Table 11.1 Incidence of the most recent type of potentially legal problems among native Dutch and immigrant groups in a 2-year period (% of respondents)

Type of problem	Originally Dutch (N = 183)	Immigrant groups (N = 207)
Employment	27	19
Relationships/other family matters	10	17
Money problems	11	9
Injury/health	9	5
Social benefits/public services	5	9
Faulty goods or services	6	3
Damage/insurance	5	8
Residential property ownership	5	1
Living in rented accommodation	3	5
Problems with neighbors	2	3
Immigration laws	<1	7

Source: Author's own table with data from Combrinck-Kuiters and Jungmann (2005)

11.2 Private Household Problems and Resolution Strategies

As might be predicted, initially the Dutch are relatively more often confronted with problems concerning employment and residential property ownership. Immigrant groups on the other hand, are more often confronted with problems concerning social benefits and immigration laws. Furthermore, immigrant minorities experience more problems with respect to family matters (Table 11.1). This might be due to the fact that they have more children under the age of 18 than the native Dutch population.

The survey further focused on the ways in which people handled their problems.

What were the resolution strategies of the 1,704 problems mentioned in the Dutch survey of legally relevant problems? We distinguished three basic types of reactions (Fig. 11.1):

- 10 % of the people do not take any action whatsoever, they 'lump it'. They do not attempt to contact the other party, do not go to an expert for advice or help, and do not try anything else to tackle the problem.
- 46 % are 'self-helpers'; they take the problem resolution into their own hands without seeking any form of legal aid.
- 44 % are 'advice seekers'; they turn to one or more experts or organizations for legal advice and/or help to tackle their problems.

Altogether, official proceedings are invoked in 11 % of all problems. Among these we include all formal procedures in which a third party takes a decision: e.g. judicial procedures (court), arbitrage, binding advice, administrative complaint ('*bezwaarschrift*'), etc. Depending on the nature of the case, such official proceedings may go through various stages and result in a decision by a third party (8 %). However, we also see that parties may still decide to settle the matter in the course of the proceedings (2 %). Not even a decision at the end of official

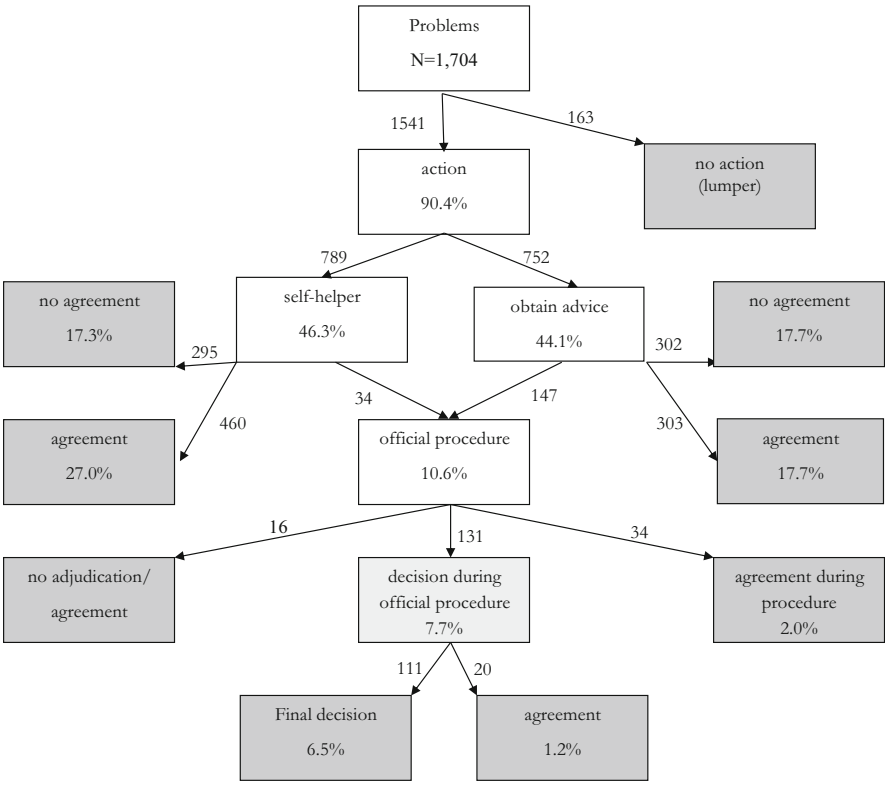

Fig. 11.1 General scheme of the steps in the selective course of choosing strategies for problem solving. *Source*: Authors' own diagram

proceedings is necessarily final. Parties may start talking to each other again in the course of proceedings and still reach agreement (1 %). Finally, a party may simply walk away (1 %).

The strategies differ significantly by types of problems. With consumer and money problems people often deal by themselves (Table 11.2). Work-related problems are either addressed directly or they are taken as a "given" situation like other long-term relationships. People might fear to jeopardize the workplace relationships and spoil the work atmosphere. Engaging professional experts for advice is most frequent among property owners (often related to mortgage and banking questions), in family matters related to divorce and child support and injury due to accident and/or work which might call for medical as well as trade union support.

Looking at the plaintiffs' side, for some problems of property management (acquisition, mortgage) legal steps are imperative. For debt collection it might be easy to first invoke a dunning procedure before entering into complicated steps for

Table 11.2 Types of justice-relevant problems and frequency of invoking official procedures, in % of the number of problems mentioned

	Official procedure (N = 181) (%)	Judicial procedure (N = 92) (%)	Non judicial procedure (N = 89) (%)	Total of problems (N = 1,704) (%)
1. Employment	18	17	19	26
2. Residential property ownership	19	16	21	15
3. Landlord of rooms or property	3	3	3	2
4. Tenant in rented accommodation	8	2	15	8
5. Faulty goods or services (consumer)	9	4	14	22
6. Money, debts	17	13	20	13
7. Relationships and other family matters	13	25	1	7
8. Children under 18	3	7	0	2
9. Health problems (due to accident/work)	4	4	3	3
10. Other (discrimination, immigration)	6	8	3	2
Total	**100**	**100**	**100**	**100**

Source: Author's own compilation

retrieval. Divorce most often needs a pro forma procedure and only in a minority of cases it is followed by endless post divorce litigation.

11.3 Comparison with Other Countries

The so-called 'legal needs' studies depend on survey research in which respondents have to indicate whether they experienced a set of problems that were 'serious' or 'difficult to solve' during a specific reference period. It is difficult to compare these survey results because different research methods were used. The studies used different modalities of data collection (telephone, face-to-face, internet surveys), different sampling frames (specific subpopulations versus entire population, individual versus household), and different questionnaires (varying numbers and types of problems, different reference periods). However, some striking differences emerge between the countries studied that (probably) cannot be attributed to different methodologies.

In general, people in the Netherlands report more legally relevant problems than those in England/Wales, Scotland, Canada or Japan. The Dutch cite more

employment problems (30 % compared to 6 %, 17 % and 3 % in the three other countries respectively), consumer problems (32 % compared to 13 %, 19 % and 5 % respectively), money problems [22 % compared to 10 %, 34 % (n.a.) and 4 %], and problems with residential property ownership (35 % compared to 14 %, 5 % and 8 %). The differences are most notable with respect to economic transactions.

However, if asked what they do about them, the Dutch more often tackle the problems themselves. The high score of self-help among the Dutch is facilitated by a traditional supply of informal complaint and support institutions: consumer problems are more often settled by agreement between the parties, and so are employment and housing problems. They reflect the easy access to a wide scale of out-of-court resolutions, which means that the Dutch traditionally went to court less often than most other West-Europeans (Blankenburg 1995). The experience of problems is not randomly distributed across the survey populations: Differences in age, economic activity, income, educational level, family type and health status coincide with differences in incidence rates. The incidence of problems is higher among the age category between 25 and 40 years; divorced persons or single parents; higher educated; people entitled to social benefits and self-employed people; people with a chronic illness or disability. Problems tend to occur in clusters (Currie 2005; Pleasence et al. 2004; Mulherin and Coumarelos 2007).

The results generally confirm the participation theory of those who are in their most active lifespan, having a job, family life and a high consumption level. But it also points out a comparison of exactly the opposite, where people who are excluded from social relationships run into problems. In all countries, those who are divorced, disabled or entitled to social benefits encounter more problems. Several studies therefore conclude that experiencing legally relevant problems is one aspect of the broader problem of social exclusion (Currie 2007; Pleasence et al. 2004).

However, we should be aware of one methodological caveat. If respondents identify many problems but do not act by going to lawyers and courts, it might simply indicate that they have been more sensitive to the question of the interviewer but not to the problem as such. This may be illustrated by a comparison of households in the Netherlands with those of England, Wales and Scotland (Table 11.3).

Times have changed, however. In a recent overview by the Council of Europe in 2004, the Netherlands ranks even higher than Germany with their caseload of civil and administrative court cases, and certainly higher than the UK and most other West-European countries. Some doubts, however, might be raised as to whether the most recent increase of litigation rates in the Netherlands might not be triggered by changes in caseload counting. The study also reveals that the rate of incoming employment dismissal cases in the Netherlands is among the highest in Europe. After traditionally having been dealt with out of court by industrial commissions, they suddenly increased in the 1990s with the rise of non-standard employment contracts, which are not fully protected by collective agreements (CEPEJ 2006/8). The result can be seen in the current policy debates of the Dutch Parliament where

Table 11.3 Incidence, strategy and outcome of legally relevant problems in the Netherlands and UK (%, multiple answers)

	Netherlands (1998–2002) (n = 3,516)	England/Wales[a] (1992–1997)	Scotland[b] (1992–1997)
Incidence of (non trivial) problems	67	34[c]	23
Money	22	9	6
Consumer goods or services	32	8	6
Employment	30	7	4
Housing/property	20	11	5
Family matters	13	3	4
Health	7		4
Other	7		2
Strategy:			
– Passive	10	5	3
– Self-help	46	35	33
– Obtain advice	44	60	64
Outcome:			
– Agreement	48	34	32
– Concluded by adjudication	7	14	9
– Putting up with the problem internally	36	49	54
– No action taken (lumping)	10	5	3

Sources: On the Netherlands author's own compilation, on England/Wales and Scotland as indicated in the following notes

[a]Genn (1999)

[b]Genn and Paterson (2001)

[c]A more recent study reported 37 % legally relevant problems over a 3.5 year period 1998–2001 (Pleasence et al. 2004)

the government is proposing legislation leading to more and more conflicts going before the courts.

We should also consider the factor of the regulation of lawyer fees, which so far did not appear in our Dutch-British comparison. It might, however, explain in part the high level of German litigation caseloads. If lawyers/advocates are remunerated according to a fixed (and non-degressive) percentage of the value at stake—as is the case in the strict fee regulation of Germany (BRAGO)—this encourages litigation for small stakes (which account for the bulk of petty cases), but leaves lawyers with the necessity of negotiating additional fees for larger stakes.

Murayama and Matsumura (2008) allow drawing further comparisons between Japan, the US and the U.K. in trying to explain the low litigation frequencies of the Japanese (in comparison with the British and even more so with Americans in the US). Their explanation lies in the infrastructure of institutions handling claims. They point particularly to traffic accidents, which in California, compared to Japan, lead twice as often to torts court cases. While Californians consult "their" lawyer,

Japanese rely heavily on insurance agencies, which they assume to be reliably neutral in their interests.

We made a similar comparison of traffic tort in Germany and the Netherlands (Simsa 1994). Germans routinely leave it to a lawyer to handle the case, for which two thirds of all car owners are covered by legal cost insurance, while the Dutch rely mostly on their insurance making every effort to handle the cases as quickly as possible. Considering that normally costs of traffic accidents are split between two parties, which are insured, it would be inefficient to run up high costs of conflict resolution—with the exception of long-term injury, which might run into life-long payment obligations. German insurance regulators have not been acting as quickly as the lawyers, who have long maintained a monopoly of handling all legally relevant conflicts. Only recently they had to accept legislation to allow a global resolution of traffic accidents by insurance agents.

As long as the lawyers' monopoly was in effect, traffic tort cases in German courts ranked almost as high as in California, while in the Netherlands we observed only half as many traffic tort cases as in Japanese courts.

11.3.1 Dealing with Problems as a Function of Social Constellation and Legal Infrastructure

Infrastructures of legal advice for conflict resolution evolve out of similarities of the subject matter and the respective party configuration. Consumer problems may serve as an extreme example of a great similarity. Frequently mentioned by respondents in all countries, they do not often lead to legal action. A well-managed producer or sales company offers complaint services, which in the interest of good customer relations might be more generous than the law requires. However, wherever competition fails, customer discontent is structurally disadvantaged as the individual stake is usually too low to weigh against the costs of a lengthy conflict. Representation by public and private consumer organizations therefore compensates for the individual weakness.

While in many surveys housing property ownership problems and the related conflicts with public administration rank highest, in most European countries landlord-tenant issues still hold a special place in litigation. In post-communist countries, but also in Western Europe depending on the extent of the liberalization of the rental market, its growth continued throughout the 1990s. Lawyers as well as collective organizations generate lengthy court cases from it. Most disputes are initiated by landlords who threaten to evict tenants. While the tenants can afford to play for time, the landlords often threaten eviction in order to reach some sort of settlement. Tenants sometimes demand repairs, but they rarely file court claims against their landlords. Their rights can often be defended only when group actions force housing corporations to negotiate. In such cases, courts are usually invoked only after collective bargaining has failed.

National differences can also be observed around tort cases. Americans apparently mention liability more often than most Europeans, even though the media stories have stimulated liability claims (for example: medical malpractice) worldwide. The most frequent type of tort claims, however as we have seen infra Sect. 11.3, stems from traffic accidents. Comparative research has shown twice as many traffic tort cases in California compared to Japan, but in Dutch courts again only half as many traffic tort court cases as in Japan. The explanation lies in the infrastructure of insurance claims management, which in the Netherlands is largely regulated quickly and efficiently, out of court. The example demonstrates that a substantive comparison can explain national differences only by breaking down very specific strategies of advice and problem resolution.

Labor conflicts are a good example to illustrate national peculiarities. They stem from the long-term struggles of the collective parties to prevent judicial involvement in industrial conflicts. Each country can tell their own story about the access to legal institutions that evolved out of the individualization of the employment contracts. Employment being regulated by collective as well as individual contract, they regularly handle dismissal and redundancy first by arbitration, but often with a recourse to courts if this fails (see the various ADR institutions in the USA or industrial tribunals in the UK). In countries with special labor courts (like the French *conseils de prud'hommes* and labor courts in Belgium and Germany) the tripartite constellation of the conflict is represented on the bench. The institutions of advice and representation before going to court correspond with the mix of collective and individual interests of the conflict: trade unions (and employer associations) propose their special legal advice services, often offering even general legal advice as a membership privilege.

There is one area of conflict, which has escaped the general trend towards more litigation: divorce as it has become a normal expectation in modern life, and legal conflicts between separating spouses or divorcees have largely been de-escalated. Frequently mentioned by survey respondents among the problems, they most often remain in the private sphere for which legal action (even formally consulting a lawyer) is considered inappropriate. Legal policies in many countries reacted to a rise in routine divorce by introducing simple request procedures, sometimes without even summoning the parties to appear before a court. Lawyers in the Netherlands handle about 60 % of divorce without adversarial litigation. Property claims, including social insurance rights, which make for juicy stories around the water cooler, are increasingly negotiated before filing divorce papers in court.

What keeps courts and family lawyers busy are post-divorce proceedings, often including quarrels about child support and/or custody. These occur in only a minority of all divorces, but as they often concern revolving-door problems such as child custody, spousal and child support the caseload remains high. Mostly they are handled by request proceedings, but their frequencies have increased disproportionately so that most countries now count more post-divorce cases than divorce proceedings.

11.3.2 Can We Control the Quality and Cost of Civil Justice?

Politicians have been asking how the costs of civil justice can be controlled and limited. They seem firstly to target managerial control of judicial organizations. The reports about such attempts invariably refer to court reform in terms of a specific task within judicial services; which in turn can hardly be generalized to legal systems across national boundaries. In international comparisons, however, the concept of what the justice system should provide varies greatly. The discussion of limiting judicial costs cannot be seen apart from the question of which tasks should be included under the umbrella of the justice system. Without specifying the issue at stake, talking about average procedural indicators (such as average duration of procedure) remains pure nonsense.

An initial look at how procedures before (German) first instance courts were terminated reveals patterns, which we can understand as being inherent in the kind of issues at stake. It should be obvious that time and costs differ widely between debt enforcement (most end by default), tort cases (often adversarial with evidence taking), landlord tenant disputes (with tenants playing for time), family courts (with quick divorce, but many follow-up procedures) or labor courts (frequently ending with settlement) (Fig. 11.2). We are confident that these patterns repeat themselves in civil courts across quite different legal systems.

Separate measures must be done for the different issues at stake taking into consideration their typical patterns of termination either by default, settlement or adversary decision. In particular for mass procedures, court performance differs considerably. Efficiency depends on organizational structures, the streamlining of interactions between judges and clerks, the co-ordination with advocates, and co-operation with bailiffs. Comparing national systems court managers can learn from the more efficient courts and devise instruments for improving the organization of the less efficient ones. But very often the task description and procedural rules of national justice render it impossible to easily imitate successful organizational devices.

Costs can only be evaluated if held up against indicators for quality of judicial performance. While for a long time appeal to a higher court was considered the only avenue for clients to challenge a court decision, court managers nowadays also try to respond to complaints about the handling of cases and correct problems. These include waiting times, information availability and friendly treatment as elements of performance quality. Courts are seen as public services, which have to meet the expectations of their clients. Instruments such as complaint boards and a justice ombudsmen can render court organizations responsive to their clients, quality measurements can make use of indicators of waiting times, information on the progress of a case can be improved and the duration of procedures better controlled.

Reform projects are presently underway in most European countries. Most important is the degree to which judges are actively involved in developing measures of comparison. Two fairly developed systems on the scale of low versus high participation by judges/magistrates are informative: England/Wales relies on a

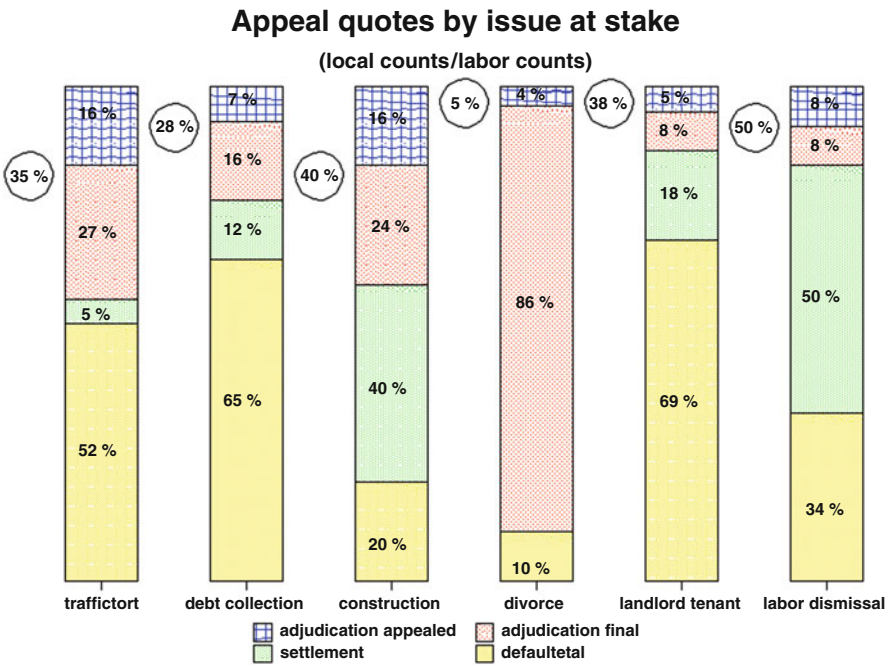

Fig. 11.2 Termination: withdrawal etc., default, settlement, adversary decision, appeal. *Source*: Author's data of local German courts, 1995

highly centralized inspectorate system, the Netherlands on centrally monitored, but de-centralized project groups.

11.3.3 Differences in Litigation Rates

Looking at a rough indicator such as the litigation rate related to the population size, we discover large differences among civil law countries (Table 11.4). We might subdivide the indicator by comparing the frequency of labor law, tenant law, liability or contract law cases before courts, and we might relate them to the relevant populations, economic activity or accident rates. With all such refinements we might get a better insight into the factors which make for more or less legally relevant problem situations, but comparisons between countries (or metropolitan areas) with similar economic conditions show that such control of the causalities of legal conflicts does not do away with all of the litigation differences. There must be additional factors, which lie in the conditions of the parties with legally relevant problem situations taking the step of mobilizing court procedures.

In the past 20 years a considerable body of literature has been assembled on such factors in people's personal lives. Participation theory explains how legal problems

Table 11.4 First instance civil litigation rates per 100,000 inhabitants 1990–2004

Litigation first instance	Norway	Netherlands	Germany	Italy	Spain	England/ Wales
Civil cases—filed 1990–1995	Preceded by conciliation boards ± 290	1,393 1,626	W[a] 3,038 U: 2,656	1,299 1,227	1,344 1,897	6,500 4,719
Litigious civil cases filed 2006	**285**	**4,256**	**3,738**	**6,159**[b]	**1,962**	**3,011**

Litigation first instance	Estonia	Poland	Czech Republic	Hungary	Slovenia
Cases filed 1995		1,108	2,120	1,842	1,350
Civil incl. divorce	1,292				
Litigious civil cases filed 2006	**1,873**	**3,045**	**2,793**	**1,639**	**1,268**

Sources: For 1990/1995 IRSIG-CNR, Bologna 2000/Non-criminal cases: CEPEJ (2006); CEPEJ 2008

[a]West 1990 only West Germany/United 1995 united Germany/NL does not include kort geding (interim judgments) estimated at 10–15 % of caseload

[b]Italy 2004 includes social law cases but excludes 2,706 labor dismissal protests

are correlated with the extent of one's social activities. Those in their most active period of life, having a job, a family and a high consumption level, also have the most problems. But the correlates also point to the opposite: where people are excluded from social relationships, they run into problems. Those who are divorced, disabled or entitled to social benefits encounter more problems in all countries. Problems tend to occur in clusters. Those faced with family problems have a greater risk of facing money problems or landlord tenant conflicts. And immigrants not only suffer more problems with discrimination, but also experience significant problems with housing and welfare administrations. Experiencing legally relevant problems is only one aspect of the broader problem of social exclusion (Pleasence et al. 2004).

Similar problem clusters—though much less investigated—may exist among small businesses, and certainly among big corporations. What we have studied is the reluctance of private as well as business actors to mobilize the law by going to court.

Some of the litigation increases may be caused by changes in the definition of what is "litigious litigation". The Netherlands for example has for a long time counted simple non-controversial procedures (*verzoeksschriften*) as "non-litigious", but with increased lawyer activism these became more work intensive, they were therefore redefined as "litigious". Administrative caseload controls may have helped motivate the redefinition. As a result the official caseload figures doubled after 2006. Thus, keeping in mind such administrative tactics as redefining recordable data, we can try to compare the cost of justice by analyzing the budgets of the judiciary in different countries—which again can only be an approximation of valid indicators of judicial organization.

11.4 Budget Comparisons of Justice Systems

Court reforms take their given set of judicial tasks as granted when they try to minimize costs and optimize quality. They look at the balance of costs and revenues, but do not control their budgets by allocating costs and revenues to specific tasks. The difficulty starts when splitting budgets of civil and criminal justice and those of other tasks, which courts perform. It continues with specialized branches of administrative, social and labor courts, which in some countries are budgeted within the judiciary, while in others appear separately in the budgets of other ministries or even community services.

Problems of comparability are not restricted to costs; they also have to account for revenues. Revenues may be gained by fees and by fines imposed by courts, but even these can be attributed to specific branches of the judiciary, they are usually accounted for in the overall budgets of the judiciary.

These factors taken together produce astounding differences of judicial budgets (Table 11.5 and Appendix 1). Many countries try to cover their costs of civil and administrative courts by raising court fees for each procedure, others do not do anything like this. They also gain revenues by court-imposed fines, but how much this involves depends on fiscal rules, which leave some fines to be levied by municipalities (parking) or the police (traffic fines), and others (more or less) to the courts.

In all cases, revenues are not directly related to the costs of judicial services:

– Fees are not determined by costs and time spent, but rather by fixed tariffs, so that they form a mixed collection where most are short routine procedures, which subsidize the relatively more rare, long and elaborate procedures (particularly if these are fought for a relatively small amount at stake). The idea of public service does not allow for a strict price allocation by time and effort spent (as does hourly fees of lawyers), but rather by some kind of re-distributive scheme. The degree to which such a scheme is considered to cover the costs of civil procedures varies. (In other branches of the judiciary, there is not even an attempt to reach such a goal.) Some countries (like Spain according to Art. 119 Constitution) do not allow for fees to be increased for procedures as they consider civil justice a public service. Other countries follow a cost covering principle of civil justice. Baldwin (1997) states: “It is not easy to determine how much the civil justice system costs. Total expenditure of the Court Service in 1996–97 was £590 million. However, as far as the civil courts are concerned, an attempt has been made in England and Wales for many years to ensure that the civil justice system is to a substantial degree self-financing, and it has been accepted that the fees imposed on users of the civil courts should largely, if not wholly, meet the costs of the civil justice system, howsoever defined. There are, however, certain complications about what should be included in these costs, and comparisons between gross and net expenditure are somewhat hazardous as a result. This requirement has been made more and more rigorous over the years, and it is current Government policy that it should approach 100 per cent.

Table 11.5 Gross operating budgets of the judiciary 2004

Euro per capita	Norway	Netherlands	Germany	Italy	Spain	England/Wales	Estonia	Poland	Czech republic	Hungary	Slovenia
Public expenditure											
–Courts	35	46.8	86	47	52	8	15.6	17.3	24.8	27.4	55
–Legal aid	30	23.5	5.6	1.1	2.8	57.8	1.0	0.4	0.8	0.1	n.a.

Source: CEPEJ, European Judicial Systems 2004, Council of Europe, Strasbourg 2006; *Sources*: CEPEJ 2004, Strasbourg 2006. Note on post-communist countries: Legal aid almost nil

By 1996–97, over £243 million was recovered in court fees, a figure that represented 91.3 per cent of the Court Service's total costs of court business relating to the civil courts. The figure includes charges for accommodation, judicial salaries, and the proportion of management costs attributable to the civil courts but it does not include capital costs".

– The logic is different as far as the second, mostly bigger sort of revenues, are concerned: fines imposed by courts. If the offenders are taken to court, or if they contest an administrative fine and thus have to appear in court, the court will add money to their budget. This also includes transaction fees proposed by the prosecution, which are levied for the great majority of petty crimes by French, Belgian and Dutch prosecutors. The degree to which penal and administrative fines go to court budgets varies, but usually, fines imposed by the police and by municipalities (i.e. traffic and parking offences) are decided with the fiscal authorities. (A unique invention has been introduced in Germany with Art. 153a StPO, which allows the allocation of settlement fees to charitable organizations). But usually, fines imposed by courts, as well as settlement fees, form part of the budget of the judicial services. They can cover a great part of judicial costs. (Even within single countries, coverage can vary: among the German states they vary from almost 100 % coverage in Bavaria and Baden-Württemberg to 40 % in others, with an average of 57 %).

In Austria, Germany, and The Netherlands, judicial budgets receive considerable revenues from judicial fines and levies, whereas in Spain, Italy and—as far as we know—Portugal, the judiciary does not gain any significant revenues in this way. Germany stands out with the most extensive court system in Europe, but it manages to cover more than half of its costs by court revenues. Thus the overall cost comes close to the Italian or Portuguese expenditures, which receive hardly any revenue from court procedures.

11.4.1 Legal Aid as a Cost Factor

Wherever court fees are very high, legal aid schemes to compensate low-income parties in order to facilitate their access to justice. In traditional legal policy this takes the form of court fee waivers (which might be seen as a reduction of revenues from fees). However, to the degree, that countries extend legal aid to also cover lawyer's costs, they form part of the judicial budget. It may seem plausible that it is mainly in Common Law countries that lawyer costs are seen as essential part of access to law, as here most of the procedural work is left to the parties and is much less a responsibility of the courts, but the idea of legal aid for lawyer's fees also caught on in some of the more generous welfare states of the 1980s, such as the Scandinavian countries and the Netherlands. No country in Europe, however, runs a legal aid scheme as comprehensive and as expensive as the UK with legal aid costs amounting to more than the overall costs of civil and criminal justice.

Table 11.6 Legal aid in the budgets of the judicial system

Justice budget (2004)					
Euro per capita	Norway	Netherlands	Germany	Italy	England/Wales
Legal aid	**35**	**23.5**	**5.6**	**0.8**	**53.8**
Minus revenues	− 30 %	− 7 %			−25 %
Net budget	**25**	**21**			±**40**
Percent of criminal defense	51	46	19	99	57

Source: CEPEJ 2002, 2004

Notes: Net budget Norway 2007 budget data; Legal aid subsidies (civil/social and administrative law) and duty solicitors (criminal defense) in most countries remain within the judicial budgets, while in England/Wales they are budgeted separately

% show which part of legal aid may be covered by recipients of legal, thus net budget figures are actual budget expenses

Bear in mind that including legal aid in the budget of the department of justice means including part of the forensic activity of the law profession within the concept of "public cost of justice". Countries with high legal aid provisions thus work according to official fee schemes. In as much as a sector of a legal profession becomes dependent on legal aid subsidies, it is included in the budget and the conception of the system of justice. Critics therefore label them "a partly socialized legal profession". On the other hand, it is obvious that countries with insignificant budgets for legal aid (for consultation outside of court as well as representation in court) do not fulfill the qualitative minimum of granting equal access to justice. The decision to include legal aid costs in judicial budget comparisons highlights that the variations in costs of the system of justice can be taken as a blueprint of the priorities of national legal policy. If we add prison costs, the relative importance of expenditures becomes even more apparent (Table 11.6).

Of course, next to the costs the range and the form of delivering legal aid should be considered. The Dutch have a tradition of legal aid advocacy since the 1970s, so do Norwegian lawyers. Since the 1990s, however, the support for legal aid cases has been restricted, so that few 'lawshops' are still active. Means testing clients for eligibility was felt to be cumbersome. In 2005 they introduced a half-hour free advice ("legal counter") for everyone, with a credit system for everybody but the neediest legal aid clients who do not have to pay anything. Germany provides limited first advice and grants procedural cost subsidies for procedures only after having thoroughly tested the merits of the claims—with high judicial costs and lengthy procedures as a result (Blankenburg 1999).

11.4.2 Size and Salaries of Judicial Staff

Most of the costs of the justice system are salaries for personnel. Thus, it should not surprise anyone that the **size of the staff** explains most of the differences in expenditure (Table 11.7). However, we need to qualify this for the general wage

Table 11.7 Professional magistrates per 100,000 inhabitants 2004 gross salaries and ratio of magistrates/staff

Judicial personnel per 100,000 inhabitants	Norway	Netherlands	Germany	Italy	Spain	England/ Wales
Prof. judges	**10.9**	**10.4(+ 5.5)***	**24.7**	**20.7**	**9.9(+2.8)**	**2.2(+5.5)**
Magistrates England		56.2				54.7
Clerks, staff	21	**3.7**	71	67	89.2	16.6
Prosecuting officers	**15***		**6.2**	**3.7**	**4.1**	**5.3**
Yearly gross salary of judges in Euro						
Starting level	70,477	65,000	38,829	34,582	46,412	150,135
High level	111,688	110,000	86,478	112,993	108,594	265,390
Starting judges' salary as ratio of average salaries in the country	**1.7**	**2.1**	**2.2**	**1.6**	**1.9**	**4.1**

Judicial personnel per 100,000 inhabitants	Estonia	Poland	Czech Republic	Hungary	Slovenia
Prof. judges	**18.1**	**20.3**	**28.2**	**27.3**	**39.0**
Clerks, staff	17.5	20.3	26.6	27.2	39.4
Prosecutors	**13.8**	**14.1**	**10.4**	**14.4**	**8.6**
Yearly gross salary of judges in Euro					
Starting level	20,620	11,633	16,344	20,729	22,266
High level	28,353	37,217	37,464	34,426	48,260
Starting judges' salary as ratio of average salaries in the country	**3.7**	**1.9**	**2.6**	**4.9**	**1.6**

Source: CEPEJ 2002 and Strasbourg 2004

Bold values signify the rate of pro. judges per 100,000 inhabitants, the rate of prosecutors per 100,000 inhabitants and the ratio of starting judges salaries compared to average in the country

*NL add 5.5 for occasional judges/Prosecution officers in Norway incl. criminal investigators

Salary costs for the employer might compare quite differently due to various benefits. * Italian figures include social insurance—if deducted (estimate at least 33 %), Italian magistrates rank at the lower end of the net salary scale. *German figures are based on salary costs, not taking account of implicit pension rights, social and health benefits—for employers' personnel costs add at least 20 % on top of salary

Figures in brackets in Netherlands, Spain and England/Wales represent estimates for part-time judges

levels of each country: post-communist countries still have considerably lower wage levels and thus also lower salaries for judicial personnel. Notable is also the size of supportive staff: some western countries employ two clerks for each judge, others three or more (for example Spain). Post communist countries on the other hand, have about as many judges as they have clerks, but they employ three times more prosecutors than western Europeans. These figures may raise some questions about the organization of the judiciary; they are (still) partly explained by the functional priorities back in communist times.

Staff ratios show that clerks are in no way a substitute for professional personnel. Quite the opposite, Germany with its **many judges and prosecutors, also employs a high number of court staff,** while Italy with a low number of judges also counts fewer than average court clerks. France, however, employs a more than average number of staff—however, this is due to the priority of juvenile protection, which alone employs a sizeable staff.

The British system (UK) builds on a great number of moderately paid personnel with a small number of highly paid professional judges at the top of the scale. The national court system employs a few well-paid professional judges and a rather limited staff. Local magistrate courts use more personnel very moderately paid by communities. The British device for achieving low personnel costs lies in "non-professional magistrates" fulfilling judicial tasks. They are partly salaried, often part-time without university degree but with practical expertise and some training.

So too, in Latin countries considerable numbers of non-professional magistrates are fulfilling (part-time) judicial tasks, while the German judiciary (and other German language countries) strictly privilege only professional judges. The German judiciary does, however, employ court clerks who fulfill routine tasks (*Rechtspfleger/Amtsanwälte*) with quasi- judicial authority. In the French budget study these are included among "non-professional magistrates".

11.4.3 Procedural Tools of Cost Control

As long as court reform stays within a (national) regulatory system of justice, the possibilities of using procedural alternatives for court cases are limited. This holds particularly true for courts in Civil Law countries where the rules of procedures are given by codes of law, while Common Law courts have some leeway in changing their rules of court according to priorities of efficiency and management. But even in the more strictly regulated codified systems, procedural efficiency can be sought by stimulating the use of efficient proceedings:

- local priorities can be implemented by using **summary procedures** extensively (cf. largely used for payment orders). A very successful invention of some Presidents of civil courts in the Netherlands was their use of provisionally enforceable relief (*'kort geding'*), which was so successful that it was introduced into all civil court proceedings in the Netherlands; and it is increasingly used (as *référé*) by French district courts. When used by a party to clarify a legal controversy, it has led in more than 80 % of cases to quick final decisions, while in cases of disputes parties can invoke the full adversarial procedure.
- if parties agree, they can use summary procedures (cf. the general trend towards **simplifying non-controversial** divorce procedures which in the past 30 years has greatly reduced the case load of civil courts in many countries).

– and finally, many countries enacted legislation to allow for (local) experiments with **mediation and settlement procedures**, which may be encouraged as a means of cost control, but are more regularly promoted for quality reasons. Settlement can also be encouraged within adversarial procedures by finalizing the exchange of adversarial positions by offering a civil action settlement before actually taking the evidence offered.

Legal policy determines how much procedural scrutiny courts have to provide, what possibilities parties have to prolong proceedings or speed up decisions. In this sense, procedural rules and regulations have an impact on the costs of judicial system, and so do the litigation patterns by which parties and their attorneys make use of them. However, the variation of procedural alternatives also renders cost comparisons extremely unreliable, as each service from one jurisdiction to the next offers a somewhat different "product".

11.4.4 Puzzles of Judicial Cost Control

With some of the difficulties of budget comparison in mind, we can finally show why the questions on cost control and limiting the costs of justice can only be answered for each country separately.

– Table 11.8 presents some data of duration of procedures as the simplest quality measure, which allows us to frame some comparative puzzles.
– It uses case **ratios** based on litigation volume of civil courts, all courts and appeal rates. (Bear in mind that these are not the caseload per judge, as they include all judges except for penal court cases). For quality measurement it has not much more to offer than appeal rates and basic data for the duration of procedures. As average duration data are considered useless, duration of comparably frequent routine cases such as debt enforcement (cashing a bad check) and tenant eviction for non-payment of rent are taken. Duration data have been collected by Lex Mundi advocates in the major city of each country.

Rank order correlations in Table 11.8 lead to a few questions, which are mentioned here in order to stimulate further understanding of the table:

– Germany, which employs the highest number of professional judges as well as other court personnel, also has the highest litigation rates of all countries compared. In spite of a sizeable staff, the duration of cases is higher than average and appeal rates are also high.
– Compare this to the performance of the Dutch judiciary, which employs a low number of judges, with a high ratio of cases, but a low appeal rate and very short duration of procedures (at least for the routine cases compared here).
– And look further at the Italian case which combines more than average numbers of judges and personnel with low caseloads in first instance but an extremely

Table 11.8 First instance civil cases with clear evidence, duration in days

Litigation in first instance	Norway	Netherlands	Germany	Italy	Spain	England/ Wales
Duration in days incl. enforcement[a]						
– Collecting a bounced check	87	52	331	30	183	160
– tenant eviction for non-payment of rent	365	39	154	654	147	190

Litigation in first instance[b]	Estonia	Poland	Czech republic	Hungary	Slovenia
Duration in days incl. enforcement[a]					
– Collecting a bounced check	305	1,080	330	365	1,003
– Tenant eviction	305	1,000	270	365	1,003

Source: Djankov et al. (2002), Worldbank, Washington 2002©

[a]Duration in days, cases with clear evidence as estimated by Lex Mundi attorneys in middle sized law firms

[b]Djankov et al. (2002)

high appeal rate, so which nevertheless takes the longest duration for routine cases and battles with high appeal rates.

- Spain employs moderate/low number of judges; compared to the first instance civil litigation they have to handle a rather high appeal rate.
- British figures contain a great number of petty cases, which are dealt with by summary procedures. Other countries do not count petty cases among their litigation figures.

Looking at the entire range of six countries we might conclude that additional personnel do not guarantee a better quality of services (measured in terms of appeal rates and duration of procedures). It is evident, that greater numbers of staff normally results in a **lower ratio** of cases per professional judge/court clerk, but this does **not lead to better** performance in the terms measured here.

It is evident, that more detailed in-depth study and additional indicators for performance quality would be needed before drawing conclusions about these countries. Litigation frequencies, as they are used here, refer to procedures filed, which may terminate by default, withdrawal, settlement or decision. Which kind of termination prevails depends on the substance of the cases. High frequencies of litigation (such as those for civil litigation in England/Wales or social insurance courts in Italy indicate that a large number of routine cases can be done with summary procedures. A stroke of the legislator's pen suffices to eliminate them from the register of "litigation". Nevertheless, in-depth studies, which controlled for the different profiles of the various kinds of issues, demonstrated that certain puzzles remain.

It remains to be seen whether judicial systems with more personnel necessarily terminate cases more quickly or show lower appeal rates than those where personnel is scarce. The time, which judges (and court personnel) spend, seems independent to the efficiency of their services. The explanation of the observed differences in productivity (defined as labor costs per unit produced) lies in more or less scrutiny

given to cases (determined by such working patterns as time used for preparing a case, procedural scrutiny with both parties, written motivation of decisions). Judiciaries, which rank low on the productivity indicator, might argue that their efforts benefit the quality of handling cases. But it must be left to further research whether the clients of judicial services are interested in such additional quality—or whether these are nothing but the fulfillment of self-imposed professional standards.

Development of better measures of the **quality** of legal services should also be encouraged. Many aspects and variables explored, when trying to compare quality indicators across countries, might be illuminated by attempts to measure different levels of judicial **corruption.** Not simply incidents of bribing judges, but also more commonly bribery of court personnel to jump queues, also collusion with 'old buddies', reference groups or elite cartels. The Judicial Integrity Group together with the United Nations Committee on Drugs and Crime (UNODC) has developed some such indicators. At first glance they seem to correlate highly with our simple indicators of long delay of procedures before the courts (Transparency International 2007).

11.5 Conclusion

The conclusions to be drawn are clear: judicial systems in the civil law world as well as the common law world work at highly diverse levels of cost and quality. From a comparative perspective, some systems may be seriously under-funded; others however, spend much more money than any of their neighbors would even consider. The problem of cost control can only be addressed in the individual national context.

Appendix 1: Budgets Per Capita of the Justice System Including Prisons

Euro per capita	Norway (2004)	Netherlands (2004)	Germany (2004)	England and Wales (2004)	Canada (2000)	USA (2000)	Japan (2002)
Judicial expenditure	**35**	**47**	**86**	**8**	**21**	**80**	**40**
Legal aid (gross) expenditure	**30**	**24**	**6**	**58**	**±10**	**Incl. public defense 13**	**8 Jap. Bar bengoshi**
Prosecution	1.4[a] + Crown service est. *±25*	9 Incl. criminal police est. ±20	±10	14.5	6		?
Prison expenditure (2000)	**2006: 50**	**54**	**28**	**51**	**44**	**151**	**?**

(continued)

Euro per capita	Norway (2004)	Netherlands (2004)	Germany (2004)	England and Wales (2004)	Canada (2000)	USA (2000)	Japan (2002)
Total	**115**	**133**	**127**	**141**	**81**	**244**	**48**
Share of GDP (%)	0.3	0.4	0.5	0.6	0.3	0.6	0.2

Sources: Overseas own research/CEPEJ (2002, 2004)

Notes: Judicial expenditure exclusive of legal aid. The European study claims to rely on gross judicial budget data, but some doubts may be raised as to the distinction between gross and net costs in comparative data sets

This comparison omits labor courts in Germany as well as all costs which are not part of the national/state budgets of justice such as local (magistrate) courts in UK. Prison operating costs in ECU, Values as of Oct. 1999 USA civil legal aid not in the budgets (±1$ per cap.), public defense is part of prosecution budget. Japan's Justice budget on the internet, legal aid not in judicial budget, bengoshi (lawyers) pay for it. Canada and US data taken from Ministry of Justice Den Haag 2000

Bold values signify judicial expenditure, legal aid (gross expenditure), prison expenditure and total expenditure

[a]Norway official prosecution costs (acc. to CEPEJ) do not include personnel, as prosecution resorts under the Crown. Including criminal investigators, high personnel rate (cf. Table **11.5**). Altogether, our own cost estimate amounts to ±25. Analogue NL ± 20 (official data)/Norway prison costs according to 2006 budget

Appendix 2: Parties Seeking Justice

Stage of the procedure	Models of regulation	Who pays?—parties behind parties
Pre-court legal advice	Hourly fees	Plaintiff investment
	Fee scheme: by action	Defendant investment
	by value at stake	
	Contingency fees	Legal cost insurance
		Membership (trade unions, Automobile clubs)
	Each party for themselves	Legal aid
Representation in court	Loser pays all	
		Liability insurance
	Court decision: split costs	Collective interest (consumer, environment associations)
Court fees		

Issue at stake	Frequent constellations
Civil: debt enforcement	Plaintiff investment, defendant loser pays costs
Consumer complaint	Plaintiff investment, settlement, costs are split
Liability	Plaintiff investment covered, by insurance/contingency fee defendant insured, split of costs
Traffic tort	Both sides insurance covered

(continued)

Issue at stake	Frequent constellations
Divorce	Parties pay, split of costs Woman plaintiff, legal aid covered
Labor dismissal	Plaintiff insurance covered/legal aid settlement, split of costs
Administrative complaint	Plaintiff investment, loser pays (1/3 of losers public administration)

Source: Author's own diagram

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Chapter 12
Why Is Litigation Density So Low in Japan? And What Are the Factors That May Have an Impact on It?

Yukio Nakajima

12.1 Introduction

This chapter examines the reason for low litigation density in Japan. There seems to be a general perception that, unlike Americans and Europeans, Japanese citizens do not use official court proceedings as a dispute resolution mechanism very often. This alleged tendency has become a subject of scholarly studies, and various explanations have been attempted. One explanation suggests that the cultural background of Japanese people is the reason why they are less conflict oriented and put more value on harmony (Kawashima 1967). Another attributes it to the flaws in the judicial system of Japan, such as insufficient numbers of attorneys and lengthy court procedures (Haley 1978). Still another tries to explain this as a result of efficient and effective means of extra judicial dispute resolutions, which Japanese people would chose as a result of rational economic decision (Wollschläger 1997).

It is difficult to determine whether and how much influence the cultural background has on the low litigation density, since it cannot be quantified. Also, the efficiency and effectiveness of extra judicial solutions are by their nature hard to measure, and, hence, there are no reliable statistics. On the other hand, measuring the impact of the judicial system is relatively easier, thanks to the availability of official statistics. Especially, since there has been a series of judicial reforms carried out in Japan in order to enhance access to justice in the past decade, it may be useful to make a comparison before and after these reforms.

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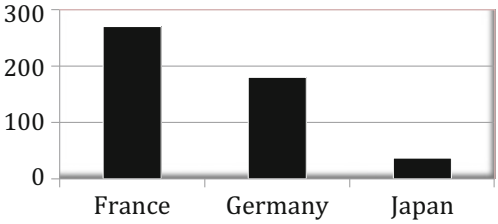

Fig. 12.1 Number of civil litigations per 1,000 population of in the year 2000. *Source*: Nihon Bengoshi Rengokai (2003)

12.2 Litigation Density in Japan

To begin with, we first need to examine the presumption. Is litigation density in Japan indeed low, compared to other countries? According to the report by the Japan Federation of Bar Associations (JFBA), the number of civil litigations per population of 1,000 in year 2000 was 37 in Japan, while France had 270 and Germany 180 as shown in Fig. 12.1 (Nihon Bengoshi Rengokai 2003). At least from this report, it does seem that Japanese resort much less on court proceedings compared to other countries.

12.3 Judicial Reforms in Japan

12.3.1 Work by the Justice System Reform Council

The Japanese government initiated its judicial system reform in 2001. The Judicial System Reform Council, which was mandated by the cabinet of the Japanese Government, made recommendations in 2001 on the comprehensive reform of the judicial system. These recommendations referred to a broad range of issues regarding the Japanese judicial system, including criminal and civil procedures, the qualification and training of lawyers, citizen's participation in the judicial system, etc. As to the civil procedures, the recommendations, suggested several measures as possible ways to improve access to justice for citizens (Justice System Reform Council 2001). Following these recommendations, the Cabinet prepared the Program for Promoting Justice System Reform, and started its work towards a reform in 2002 (Cabinet of Japan 2002).

The following is the list of measures proposed by the Council.

12.3.1.1 Lowering the Administration Fee for Filing a Lawsuit

It was pointed out that the administration fee in Japanese courts was too high, and it discouraged citizens from filing a lawsuit. Therefore, a possibility to lower these fees was examined.

12.3.1.2 Facilitating the Procedure to Reclaim the Litigation Expenses from the Defeated Party

Under the Japanese civil code, the general rule was that the defeated party should bear the cost for the litigation expenses. Usually, this was demanded after the verdict on the merit of the case was rendered. However, the formula to calculate the expenses and the procedures to make a claim was complicated, so it was often the case that the prevailing party did not actually bother to reclaim the costs. This was also pointed out as a reason that discouraged citizens from filing a lawsuit, and a revision of the procedure was considered.

12.3.1.3 Extending the Jurisdiction of Summary Courts

There are two categories of courts of first instance in Japan for general civil litigations, i.e., the district courts, and the summary courts (a high court will serve as the court of first instance in specific categories of lawsuits, such as intellectual property and competition cases, but I will disregard those exceptions in the context of this discussion). In Japan, there are 253 district courts (including their branch offices) and 438 summary courts nationally; so summary courts are relatively more accessible to citizens than district courts, especially for those who reside in rural areas.

Summary courts have jurisdiction on relatively minor cases. In civil lawsuits, they have jurisdiction in cases where the claimed value is under a certain monetary threshold. Also, summary courts have jurisdiction for procedures called "small value litigation" (*shogun sushi*). This is a simplified and expedited procedure for claims of especially small amounts.

It was pointed out that lengthy and time consuming court proceedings was one of the barriers that discouraged citizens from resorting to litigation, and an expansion of the jurisdiction for summary courts and the scope of small value litigation were considered, in order to encourage the use of court proceedings.

12.3.1.4 Enhancing Legal Aid

When ordinary citizens are involved in a dispute, they are usually not aware whether or not their problem can be solved by a legal procedure. They do not

even know whom they might consult with. If they do wish to resort to a legal procedure, they may not know how to proceed. They might not know how to seek assistance from the legal profession, or they might not have sufficient funds to sign a contract with an attorney and bring a lawsuit.

The lack of information on legal proceedings was thought to be another barrier that hinders access to justice. In order to remove this barrier, a mechanism to provide legal aid, both for information and funding was considered.

12.3.1.5 Defeated Party's Obligation to Bear the Cost for the Other Party's Attorney

Notwithstanding the general rule that the defeated party should bear the litigation expenses, each party had to bear the costs for their own attorney on their own, regardless of the outcome of the lawsuit.

It was suggested that if the party who prevailed in the lawsuit could reclaim the lawyer's fees from the defeated party, it would give more incentive to bring a lawsuit. This issue was also considered.

12.3.2 New Legislation Has Been Enacted, According to the Recommendations of the Council and the Program of the Cabinet

12.3.2.1 Administration Fee

The provisions to determine the administration fee for filing a lawsuit were amended as of April 2004. For cases where the amount of the claim was more than two million yen, the administration fees were reduced. There is a complicated formula to calculate the fee, to give a rough idea, the administration fee was lowered from 32,600 to 30,000 for a law suit claiming a value of five million yen; for a law suit claiming a value of ten million yen, the administration fee was lowered from 57,600 to 50,000 yen.

12.3.2.2 Reclaiming the Expenses for Litigation

The provisions on reclaiming litigation expenses were amended in January 2004. The procedures to calculate and reclaim the expenses (except for attorney's expenses) were simplified so that it is easier to reclaim the expenses.

Changes regarding the payment of the attorney's expenses were considered but remained unchanged, i.e., both parties still have to bear the cost of their own attorney's expenses. There was strong opposition from the Japan Federation of

Bar Associations (JFBA), claiming that obliging the defeated party to bear the opponent's attorney's expenses would actually discourage citizens from bringing a lawsuit, especially in consumer litigations or civil actions, where the defendant is a major corporation or the government (Nihon Bengoshi Rengokai 2003, *supra*). Due to this opposition, the proposed legislation did not pass the Diet.

12.3.2.3 Jurisdiction of Summary Courts

Provisions on the jurisdiction of courts were amended to expand the jurisdiction of summary courts, and came into force in 2004. Before the amendment, summary courts had jurisdiction on cases where the claimed value was 900,000 yen or less. Now, this threshold has been raised to 1.4 million yen (a little over US$14,000).

Also, the threshold to qualify for "small value litigation" was amended. Before the amendment, proceeding with a lawsuit under the small value litigation procedure was open to cases where the claimed value was 300,000 yen or less (US $3,000). Now, it is possible to use the small value litigation procedure for cases where the claimed value is 600,000 yen or less (US$6,000).

12.3.2.4 Japan Legal Support Center

In April 2006, the Japan Legal Support Center (JLSC), which is an incorporated administrative agency under the Comprehensive Legal Support Act, was established. It was nicknamed "*Hou Terasu*", meaning "Terrace of law"). The mission of the JLSC is to provide legal aid, both tangible and intangible, to citizens. JLSC provides services such as information regarding potential legal issues to citizens, and assistance to facilitate access to justice, especially financial assistance to those who do not have sufficient means.

As for the service to provide information, JLSC has a call center that can refer the citizen's calls to the relevant organizations to suit their needs. For example, if a citizen wishes to reclaim money from someone to whom they have lent money, they call can be referred to an attorney; if someone has problems in the course of transaction with an online shopping site, their call can be referred to a consumer protection organization; if someone wants to make a complaint about their welfare benefits, they can be referred to the relevant division at the municipality office.

As for judicial assistance to citizens, JLSC provides services such as a free legal consultation with a lawyer. Also, for citizens who do not have sufficient funding to pay an attorney to act on their behalf, JLSC can arrange for payment of the expenses. Provided that the applicant meets several conditions, JLSC would pay the attorney directly from its budget, which will be repaid to JLSC by the litigant, possibly under an installment plan.

According to JLSC, more than 400,000 calls were made to its call center in 2009. Free legal consultations numbered more than 230,000. JLSC advanced payment in more than 100,000 cases (JLSC 2009).

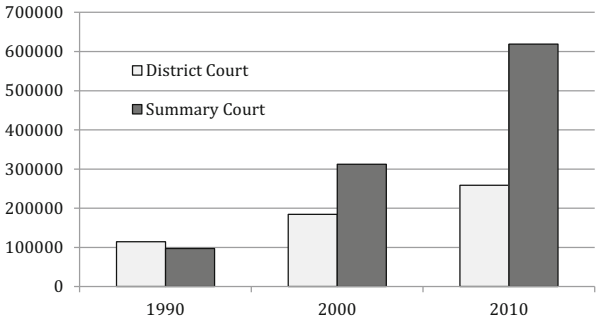

Fig. 12.2 Number of civil and administrative cases filed at the courts of first instance. *Source*: Supreme Court of Japan (2011)

12.4 Impact of the Judicial Reform Measures

How did the measures mentioned above affect the "litigation density" in Japan? These reforms started in 2001, so a comparison between the numbers before and after that year might provide some indication on the impact of the measures, as illustrated in Figs. 12.2 and 12.3.

In year 2000, the number of civil litigation cases filed in the two categories of courts of first instance was 184,246 in district courts (including their branch offices), and 312,434 in summary courts (Supreme Court of Japan 2011). In 2010, the number of cases filed was 258,329 in district courts, and 618,925 in summary courts (Supreme Court of Japan, *supra*). Looking only at this increase, it seems that these measures had substantial impact on the litigation density. But, when you compare the number of cases between years 1990 and 2000, you will notice that there was also a large increase here. In 1990, number of cases filed was 114,402 in district courts, and 97,355 in summary courts (Supreme Court of Japan 2008).

This might suggest that the increase observed between year 2000 and 2010 was only a continuation of a trend that already existed before the start of these reforms, and that these reforms did not have a major impact on the litigation density in Japan.

However, you can find an interesting pattern if you examine the situation after the year 2000 more closely. The increase in the number of cases filed at the summary court shows a steeper increase compared to that of cases filed at the district court. In 2000, the number of cases filed at summary courts was 312,434, and this number increased to 618,925 in 2010 (Supreme Court of Japan 2011, *supra*). The curve gets much steeper after 2006, although there is a slight decrease in 2010.

You may recall that the year 2006 is the year when JLSC started its service. It could be that the increase after 2006 was triggered by the judicial assistance services provided by JLSC. This hypothesis seems more credible when you look at the fact that the increase at the summary court was more evident than the increase at the district court. Since the summary courts handle relatively minor cases, it is easy to presume that a significant portion of the plaintiffs of these cases was made

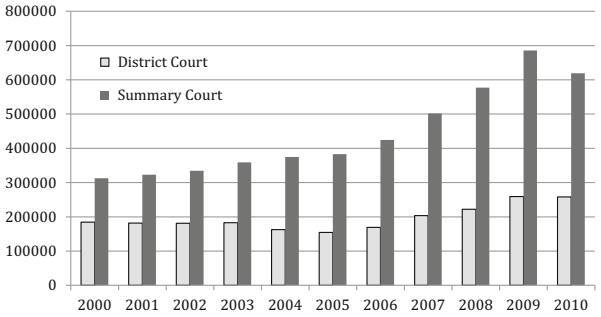

Fig. 12.3 Number of civil and administrative cases filed at the courts of first instance. *Source*: Supreme Court of Japan (2011)

of ordinary individual citizens or small and medium sized enterprises, rather than major corporate firms. These ordinary citizens and SMEs are exactly those who were envisaged as clients of JLSC. The increase in the number of cases starting in 2006 might be suggest that JLSC contributed to enhancing the access to justice for those who could not, or had never even considered going, to the court, due to lack of information or funding.

12.5 Conclusion

From the above-mentioned trend in the number of cases, it is possible that one reason for low litigation density in Japan is that citizens who might be willing to resort to legal proceedings where possible, do not have adequate information or sufficient funding to actually use the court system. Of course, this trend is not examined statistically and there has been no control for other possible variables. Additionally, less than 10 years have passed since JLSC started its operation. Therefore, it is premature to positively acknowledge the impact of JLSC's service on the litigation density in Japan.

However, it does at least seem to give us a clue of what elements affect the Japanese people's willingness to go to court to resolve disputes, and suggest that citizens are actually willing to go to court, provided that they receive proper information and assistance.

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Chapter 13
The Legal Commentary Culture in China

Shiyuan Han

13.1 Introduction

In today's China, the prevailing idea of law is that of positivism, entailing legislation as the main source of law. It goes without saying that the role of the legislators is undoubtedly important. The Supreme People's Court, in some ways, shares that role with the legislators by releasing judicial interpretations from time to time. These interpretations are composed of general rules and are to be referred to by judges in their rulings. In this way, a judge, in applying the law, plays the role of a spokesperson of the law. What about the role of legal scholars? What is their contribution to the legal process? This chapter examines these questions by analyzing the scholarly literature in the area of civil law in order to reveal their characteristics and contributions to the general development of civil law.

This chapter will begin by describing the sources of civil law from the beginning of the last Qing Dynasty. It will then proceed to analyze the available genres of legal literature and their respective purpose. The rest of the chapter will then focus solely on legal commentary literature, describing its current state in China, comparing its quality and development to those of other jurisdictions, and demonstrating the changes required to advance this genre of literature.

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13.2 Sources of Civil Law in China

13.2.1 The Drafting of the Civil Code in Early Twentieth Century China

In the nineteenth century, imperial China was facing a serious crisis of survival as its ruling powers were threatened by the intruding western powers. China's ancient law was also facing a crisis of the same kind. Under criticisms by western countries objecting that the existing laws of the Qing Dynasty were brutal and imperfect, the empire was forced to grant the US, the UK and France consular jurisdictions. In order to regain its powers of jurisdiction and abolish the system of extraterritoriality, the empire had no other options but to reform its existing laws by emulating laws of western jurisdictions. One of the products that arose from this effort was the draft of the Chinese Civil Code, which was completed by the end of 1911. This Civil Code borrowed heavily from its German counterpart adopting its *Pandekten* style, which featured five books, namely a General Part (§§ 1–323), the Law of Obligations (§§ 324–977), Property Law (§§ 978–1316), Family Law (§§ 1317–1459) and Succession Law (§§ 1460–1569). The draft never materialized, however, as the empire had reached its end before its adoption was possible.

The interest to establish a civil code was soon renewed by the Beijing government (1912–1928) of the Republic of China, which initiated the second attempt at creating a civil code. Based mainly on the Qing Empire's draft, this second draft was finished in 1925. While the first draft was modeled after the German system, Book Two of the second draft was influenced by the Swiss Code of Obligations. Concepts of mortgage and *dian* (a Chinese institution that is akin to the western pledge) were also added to Book Three on Property Law. This draft, however, suffered the same fate as its predecessor and failed to reach the implementation stage (Liang 1993, p. 62).

13.2.2 The Civil Code of 1929 Adopted by the Guomintang Government

The first Civil Code in the history of China that successfully became a binding law is the Civil Code of 1929 adopted by the Nanjing government (1928–1949). Maintaining the *Pandekten* style of the German legal tradition, this Code has five Books and contains a total of 1,225 articles. While this Civil Code was abolished on the Mainland in 1949, it remains effective in Taiwan.

13.2.3 Civil Laws of the People's Republic of China

From 1949 onwards, the development of civil laws stalled for another 30 years, before it finally began to reach its present state. During these 30 years (1949–1978), the 1950 Marriage Law was the only branch of civil law in force and remained so until it was replaced in 1980. Although two attempts were made to draft a Civil Code, interruptions by political movements impeded further progress. These efforts were ultimately brought to a halt when the legal system of the country was dismantled during the Cultural Revolution (1966–1976).

It was 2 years after the Cultural Revolution that efforts were once again poured into the task of producing a civil code. In November 1979, a Civil Law drafting group was set up under the Commission of Legislative Affairs, which is part of the National People's Congress (NPC) Standing Committee. By the end of May 1982, they had finished four drafts of Civil Law. Because the reform of the economic system began just at that time, and social life was changing continuously, it was considered that the drafting of a complete, all-encompassing civil code was not possible in a short period of time. Instead, the legislative organ took a piece-meal approach and decided to resume drafting a Civil Code in the future when conditions would be mature. Since then, specifically from 1980 onwards, many civil laws have been adopted, including: the 1980 Marriage Law, the 1981 Economic Contract Law (abolished in 1999), the 1985 Law on Economic Contracts Involving Foreign Interest (abolished in 1999), the 1985 Succession Law, the 1986 General Principles of Civil Law, the 1986 Land Administration Law, the 1987 Law on Technology Contracts (abolished in 1999), the 1993 Product Quality Law, the 1994 Law on Urban Real Estate Administration, the 1995 Guarantee Law, the 1996 Auction Law, the 1999 Contract Law, the 1999 Bidding Law, the 2002 Law on the Contracting of Rural Land, the 2007 Property Law, the 2009 Tortious Liability Law, and the 2010 Law on Choice of Law for Foreign-related Civil Relationships. In the near future, a unified Civil Law may be drafted.

13.2.4 Judicial Interpretations as a Source of Law

Aside from the statutory laws that serve as primary source of laws, another crucial source of law are the judicial interpretations published by the Supreme People's Court. According to Article 32 of the Organic Law of the People's Courts of the People's Republic of China (2006 Amendment), the Supreme People's Court may give interpretation on questions concerning specific application of laws and decrees in judicial proceeding. In fact, the importance of this interpretive function cannot be overstated. In the area of contracts, for example, interpretations that contribute substantially to the understanding and application of contract law are, among others, the Judicial Interpretation I of the Contract Law (*Fashi* No. 1 of December 1, 1999), the Judicial Interpretation II of the Contract Law (*Fashi* No. 5 of February

9, 2009) and the Interpretation on Issues Concerning the Application of Law for the Trial of Cases of Disputes over Sales Contracts (*Fashi* No. 8 of March 31, 2012; Han 2012).

In addition to these published interpretations, the Supreme People's Court is also planning to establish a guiding-case system that operates similarly to the case law approach in common law jurisdictions. The system is still at an infancy stage and it remains to be seen whether the guiding cases have the effect of precedent binding judges in their adjudication.

13.3 Contemporary Chinese Legal Literature

13.3.1 A Brief Description

Contemporary Chinese legal literature takes a variety of forms as it does in other jurisdictions: academic articles, doctoral dissertations and books. Articles, papers and dissertations are nowadays easily accessible online through the database of the China National Knowledge Infrastructure (CNKI). In the rest of this chapter, the focus will be placed on the legal scholarship presented in book form, and specifically, on commentaries.

A brief introduction to types of publications and publishers available will assist the readers to grasp a sense of China's culture of legal scholarship publications. The types of contemporary law books can be categorized into textbooks, commentaries, monographs and translations. Textbooks published by the Law Press of China and by the Higher Education Press are very popular in law schools. Each of these two publishing houses has a series of law textbooks, and each such series carries more than 40 different textbooks, covering the full spectrum of the laws. Other recognized publishers are the publishing houses of Peking University, Tsinghua University, China Renmin University and China University of Political Science and Law, which altogether have published a large quantity of high quality textbooks. In addition to textbooks, monographs are published in abundant quantity every year. Translated law books, mainly from English, German and Japanese sources, are also responding to high demand from scholars and law students. There are easily hundreds of translated law books in the market. In contrast, one of the categories where both quantity and quality are lacking is that of the commentary.

13.3.1.1 The Commentary Tradition in China

It can be said that publication of commentary legal literature has been long-established practice in China. One can turn to Tanglü Shu Yi, a commentary on the first draft of the civil code of the Tang Dynasty's Code as a testimony to the fact (Zhangsun 1983). This commentary work written by high-ranking officials at the

time not only provides statements and explanations of the laws, but also the legislative background, legislative purposes and, where it is appropriate, sentencing guidelines. Another example of a commentary in ancient China is the commentary on the first draft of the civil code of the Qing Dynasty already mentioned in Sect. 12.2.1. This commentary was originally published in 1917 in Shanghai and was written by a Chinese named Yi Shao who had studied in Japan (Yi 2008). The same author also published a commentary on the draft of the criminal procedure law of the Qing Dynasty (Yi 2012).

13.3.1.2 Commentaries Since the 1980s

In the 1980s, China witnessed an unprecedented proliferation of legislations in civil law, and the same intensity was also found in commentary literature. Each newly enacted legislation was immediately followed by the publication of a commentary on the respective legislation. For example, after the adoption of the General Principles of Civil Law in 1986, a commentary was published shortly after. This publication contains article-by-article comments, motives and explanations written by two authors who took part in the drafting of the law (Li and Du 1987). After the Guarantee Law was adopted on June 30, 1995, an article-by-article commentary of the law was published, which was also written by officials from the legislative organ (Sun 1995).

Afterwards, the "Series of Explanations on the Laws of the PRC" was published by Law Press China. The editor of the series is the Legislative Affairs Committee of the Standing Committee of the NPC. The series covers many areas of civil law including commentaries on Contract Law (Hu 1999), Marriage Law (Hu 2001), Partnership Enterprise Law (Li 2006), Property Law (Hu 2007), and Tortious Liability Law (Wang 2010). Just as Dr. K. Pissler has pointed out, the characteristics of the Series are that: (1) its volumes are edited by high-ranking cadres (e.g. the volume on contract law, published in 1999, was edited by Kangsheng Hu, at the time Chairman of the Legislative Affairs Committee, NPC); (2) individual authors are not identified; and (3) each volume is usually published shortly after the promulgation of the law explained (suggesting the assumption that the authors had insider knowledge of the legislator's intentions).

Another series, which has emerged in the field, was published by Peking University Press in 2007. Similar to the series described in the previous paragraph, the Peking University Press's series is also written by officials from the Legislative Affairs Committee of the Standing Committee of the National People's Congress (Civil Law Office of Legislative Affairs Committee of the SCNPC 2007a, b). The distinctive feature of this series as compared to the Law Press China is that it splits the commentary for each article of the law into three sections, namely "interpretations", "legislative purpose" and "related provisions". The "related provisions" include not only those of China, but also those of foreign countries in a comparative law perspective. This can be seen to be a progressive improvement over its competitor.

Aside from statutes, commentaries have also been published on judicial interpretations. One notable example is the "Series of Understanding and Applying Judicial Interpretations" published by the People's Court Press. Similar to the other commentaries just described, it is an article-by-article commentary. For each article, the commentary is presented in the following order: "gist", "restatement" and "application". The book not only uses footnotes to provide sources of the information and any incidental remarks, but also uses cases to illustrate important points of the Judicial Interpretation. From this series, readers are able to gather explanatory annotations on the most important judicial interpretations, including the Judicial Interpretation II of the Contract Law (Shen and Xi 2009) and the Judicial Interpretation on Issues Concerning the Application of Law for the Trial of Cases of Disputes over Sales Contracts (Xi 2012). Like the other two series, the series is written by officials. Using the commentary on the Judicial Interpretation on Sales Contract as an example, the chief editor of the volume is Xiaoming Xi who is one of the vice presidents of the SPC. The authors of the book are mainly judges of the SPC who have been enrolled in the drafting group of the judicial interpretation, and they are identified in the parts they have contributed to.

Some scholars also take part in the writing of commentary legal literature. One example is Professor Ping Jiang's "Explanation on Contract Law" (Jiang 1999). The book is based on contributions from multiple authors although the specific author responsible for the contribution is not identified. The book, however, does not use footnotes and therefore sources are not identified. Another commentary written by a scholar is Professor Xianzhong Sun's commentary on property law (Sun 2008). The book advances in two respects: one, by identifying the author of each contribution and, second, by providing reference citations in footnotes. There are also instances where the commentary work is singlehandedly completed, an example being Professor Weiguo Wang's commentary on Bankruptcy Law (Wang 2007). The book is an article-by-article commentary, fully referenced and with explanations added by providing "Examples".

Commentaries are not only published on national laws, but also on international treaties. Examples are Professor Yuqing Zhang's "explanation" on the CISG (Zhang 1998) and professor Wei Li's commentary on the same treaty (Li 2009).

13.3.2 A Brief Analysis

As mentioned in the previous section, the "Series of Explanations on the Laws of the PRC" is an edited work by the Legislative Affairs Committee of the Standing Committee of the National People's Congress. The preface of the series stresses that the primary aim of the commentary is to explain the law as stipulated and to reveal its legislative reasoning, while assuring readers of the authority of viewpoints and accuracy of interpretations presented. But the series has its own limitations. First, the series presents itself in the style of popular reading, understandably confining the level of analysis to basic explanation of the laws. As a result, its value

to legal scholars is limited. This is especially true because of its lack of footnotes that could otherwise provide essential research information for scholars interested in delving deeper on a specific point of law. Second, the writing style within each volume may vary greatly as each volume is composed of contributions by 10–20 different authors. The extensiveness of coverage for each area of law may also differ, for example, Chap. 2 "Formation of a Contract" of the book on contract law has 63 pages, while Chap. 7 "Liabilities of Breach" has only 14 pages.

In comparison, the "Series of Understanding and Applying Judicial Interpretations" seems much more professional on par with academic literature standards, its targeted audiences being judges, lawyers and scholars. According to Xiaoming Xi in the preface of the volume on the judicial interpretation of sales contract, the series endeavors to provide an exposition covering academic arguments as well as empirical analysis (Xi 2012, preface). However, the quality of the publication is affected by time and effort each author can afford with the consideration that they are judges who are burdened by caseloads and other responsibilities. This is especially so given the tight schedule under which the publication is normally released, i.e. usually at the same time the judicial interpretation is issued by the SPC.

As to the commentary books written by scholars, they still leave much to be desired both in terms of quantity and quality. First, the quantity of commentary work produced by scholars pales in comparison to those written by legislators or judges. Second, the commentaries that have been published thus far have not been considered influential in both academic and practitioners' circles.

In view of the shortcoming of the existing Chinese commentary legal literature, there is an increase awareness of the need for a good quality commentary in the market. There is the exciting prospect that this need may be filled, as the China Civil Law Society has just decided to publish a large-scale commentary on Chinese civil laws (Jiang AJ 2012, p. 12).

13.4 Why Advance the Genre of Commentary in Chinese Legal Literature?

13.4.1 Law Commentary Is a Symbol of Mature Legislation, Judicatory and Legal Theories

So what is an ideal commentary? An ideal commentary should provide a complete exposition of issues related to each provision of the law, supplementing simple explanation of each provision by providing analysis on the application of each. Equally important is the availability of extensive referencing that includes authoritative cases and literature on legal theories. Examples of such commentaries can be found in Germany, elaborated and extensive works like *Staudingers Kommentar*

and Muenchener Kommentar, or a concise work like Jauernig's *BGB Kommentar*. Examples can also be found in Switzerland, Austria, Japan and South Korea.

Commentaries of such a high caliber do not come by easily. Professor Tze-chien Wang from Taiwan has once written that it is a dream of his to gather up scholars and practitioners to accomplish a Commentary of Civil Law of Taiwan in 10 years (Wang 1991, p. 38). Although more than 20 years has passed since the statement was first made, Taiwan still lacks the kind of a commentary in the large-scale envisioned. It must be noted that a commentary on the law of obligation written by Dr. Weilin Ma [馬維麟] has already had three volumes released in Taiwan (Ma 1995–1996). But the commentary has not been completed. Another commentary work of considerable scale undertaken by a scholar on laws in Taiwan is a commentary on insurance law written by Professor Chaoguo Jiang [江朝國] Jiang CG 2012.

The same can be said of the situation in Mainland China. In the past 30 years, China has witnessed significant changes in the law that resulted in an accumulation of cases and legal theories, yet these changes have not been fully analyzed, documented and consolidated in one single commentary publication. It is time for the Chinese legal community to advance the genre of commentary in Chinese legal literature in order to match the legal development.

13.4.2 Law Commentary Is a Useful Tool for Law-Applications

Because of the specialization and precision of laws, every judge, arbitrator or lawyer usually only engages in one field. Meanwhile, the application of laws is always a composite task, a legal problem may require knowledge on both the substantial and procedural laws, sometimes on private law as well as public law, which means practitioners would inevitably be required to conduct work outside of their own field of expertise. On such occasions, a commentary will be very helpful as it can serve as a convenient tool that provides collective and comprehensive information on any particular article of the law of interest to the practitioner.

13.4.3 Law Commentary Is Helpful for the Learning of Law

To any law students, it is undeniable that textbooks are instrumental for acquiring basic knowledge required in law subjects. Textbooks, however, are far from being adequate in enabling students to become well versed in the laws. For those students who want to take a step forward, commentaries written by leading scholars that surveys and consolidates the prevailing perspective of judges and scholars on important issues and related arguments of the time are invaluable sources of information.

13.4.4 Law Commentary Is an Important Constituent of Academic Research

As a consequence of the peculiar legal development resulting from the process of reception of western laws, the Chinese civil laws are more accurately described as hybrid in nature, bearing features of continental legal systems as well as the common law system. Although the legislature has fulfilled its law-making mission by enacting piece after piece of legislation, far more work is left to judges and scholars to solidify the civil laws. They are responsible for breathing life into legislated laws through sensible interpretations, ensuring their workability in practice. When there is only one foreign legal system from which rules have been adopted, the corresponding legal theories of that system may help the interpretation and application of the law. When there are multiple legal systems on which the law has been modeled after, as in the case of the drafting of the Contract Law in China, the use of corresponding foreign doctrinal theories may prove to be more difficult. In this respect, as an illustration, Chinese scholars still have a long way to go to create a unified interpretation of the Contract Law (Han 2012, p. 248). When preparing a commentary of the Contract Law, scholars are not only expected to explain the plain meaning of the law. More valuably are their own intellectual contributions. One example that illustrates the difficulties arising from the clash between the continental and common law concept is related to the Contract Law's adoption of both the civil law's "*Unsicherheitseinrede*" (objection of uncertainty) and common law's "anticipatory breach" as found in Arts. 68, 69, 94 and 108. Whether a demand for performance (*Mahnung*) is necessary for termination when the other party indicates through its conduct that it will not perform its main obligation is not stated in Art. 94 (2). By a systematic interpretation of the above rules, a demand for performance is necessary. This conclusion can be inferred from Art. 69, which requires that the party who suspends its performance in accordance with its *Unsicherheitseinrede* shall timely notify the other party. If the other party fails to regain its ability to perform and fails to provide appropriate assurance within a reasonable time, the suspending party may terminate the contract (Han 2011, p. 519). This example shows that the interpretation work cannot be done just by a reception of a civil law theory or a common law one. It must be done by domestic scholars who are knowledgeable of the Chinese legal system and the associated legal theories, giving due regard to the local circumstances that affect how the laws operate in practice.

13.5 Using Commentary of Civil Laws as Scholars' Contribution to the Legal Process

There is an old Chinese saying that "*Tu fa bu neng zi xing*" (The law itself does not work on its own). The legal process is operated and affected by people living within it. In China, lawmakers contribute to the process by enacting laws. The Supreme People's Court shares the role by issuing its judicial interpretations. The main contribution of scholars, of course, is their theories. The authority of the laws or judicial interpretation is secured from *ratione imperii*, while the authority of the products of the scholars, i.e. legal theories, is secured from *imperio rationis*.

13.5.1 Legal Theories: Legislation Oriented or Interpretation Oriented

Civil law theories may generally be divided into two types, namely "legislation-oriented theory" and "interpretation-oriented theory". The former focuses on how to design reasonable civil law rules or norms and how to improve the existing civil law rules or norms. The aim of this kind of theory is to give a guide to or influence civil law legislators. The latter aims at helping judges to apply civil law correctly, by interpreting existing civil laws according to a set of methods (Han 2005). Now, in China, the idea of a division of different types of legal theories has also been accepted by scholars of civil procedure (Fu 2013, p. 169). The former theory is a theory of one-time-use geared towards a certain enactment or reform of a law. The latter theory on the contrary is a theory of an indefinite nature. As the civil law legislation continues to mature, the needs for legislation-oriented theories are diminishing while the needs for interpretation-oriented theory are growing much stronger. So it may be said that the genre of commentary is the foremost repository of interpretation-oriented theory as a theory with a long time horizon for a mature society.

Given the development in civil laws, the time has come to give serious consideration on producing a large-scale civil law commentary that China's legal literature lacks so far.

13.5.2 Preconditions for Commentary Publications

In Japan, the largest set of Civil Law Commentary has 26 volumes and was first published in 1964. According to Nakakawa et al. in their *Remarks on publishing a commentary:*

> [F]or publishing a large scale commentary, amassment of cases and legal theories is a precondition. For many years there was no large-scale Commentary in Japan, people may

> attribute the cause to the abstract and idealistic character of Japanese legal science. Meanwhile people cannot deny that the lack of experiences of modern private law is the main reason. Now, if we are planning to publish the Civil Law Commentary, this is only because we think that the accumulation of legal experiences and the development of theories of civil law has allowed us to conclude: it is the time for a large scale Commentary (Nakakawa et al. 1966) (author's translation).

Similarly in Taiwan, Professor Tze-chien Wang has pointed out that, "the defining features of a commentary book are that it illustrates the general purpose of the provisions of the law, to elucidate the relationships between different provisions, to consolidate legal theories and judicial cases, and to analyze and discuss issues that arises in the laws' application. The emergence of a commentary is conditional upon the existence of a systematic collection of cases and abundance of scholastic opinions" (Ma 1995, 1, preface).

13.5.3 What Should an Ideal Commentary Be?

As shown in the preceding section, an ideal commentary book on civil law depends on the accumulation of cases and scholastic opinions. This reminds the author what Professor E. Rabel has once said: "[a] statute without corresponding judgments is only a skeleton without muscle. And the prevailing viewpoints of scholars are the nerves" (Rabel 1925, S.4). An ideal commentary book should be a systematic and complete exposition of legal rules, judicial opinions and cases and scholastic opinions and their linkages. There are three additional criteria.

13.5.3.1 Positive Law Oriented

First, the commentary book should be positive law oriented, covering the legislation in the field. This would include the General Principles of Civil Law, the Property Law, the Contract Law, the Tortious Liability Law, the Marriage Law, and the Law of Succession. The commentary should, as mentioned above, provide the purpose of each of the provision of the legislature and reveal the relationship between each provision.

13.5.3.2 Development of Laws in the Judiciary

Second, the commentary book should also integrate contributions made by judges to the development of law within the specific area of law concerned. Here the contributions made by judges in China include not only the Judicial Interpretations of the SPC, but also rulings in single cases. For example, on the legal concept of "change of circumstances" (generally speaking, here it means "*Störung der Geschäftsgrundlage*" in BGB (§313, which is a counterpart of the "frustration of

purpose" in English common law), the commentary could only refer to cases in order to give a full account of the development of the concept in China. During the course of drafting the Contract Law, viewpoints differed drastically on change of circumstances. One reason to oppose an article on "change of circumstances" was that it was thought to be difficult for people to distinguish "change of circumstances" from force majeure and normal commercial risks. As a result, the article on this matter was deleted in the final text of the Law and instead "pacta sunt servanda" is adhered to in Art. 8 of the Contract Law.

In *Wuhan Gas Co. vs. Chongqing Gas Meter Co.*, the People's Supreme Court disclosed its viewpoint on this matter in replying to an inquiry of the People's High Court of Hubei Province that, "In the course of performing the contract, because of the change of circumstances unforeseeable and unpreventable by the parties, namely the price of aluminum as the main material for gas meters rose from 4,400 to 4,600 Yuan per ton to 16,000 Yuan per ton, . . .it will be drastically unfair if Chongqing Gas Meter Co. is obliged to supply gas meters by the originally agreed price to the other party. . .The case may be ruled according to art. 27(1)4 of Economic Contract Law, and taking the real situations of the case into consideration, equitably and fairly awarded" (author's translation). We can find several cases in which the court supported one party's application for alteration or termination of the contract where it would be unfair if it were to rigorously adhere to the legislated concept of "pacta sunt servanda".

Notably, the Interpretation of the Supreme People's Court Regarding Law Application Matters of the Contract Law of the PRC (II) has introduced the "change of circumstances" by Article 26 (Fashi No. 5 of February 9, 2009 article 26). Its Article 26 reads as:

> Article 26. When after the conclusion of a contract there is a grave change of objective circumstances, which is not foreseeable by the parties at the time of the conclusion of the contract, and which is not caused by a force majeure and which should not be classified as commercial risks, to continue to perform the contract will be obviously unfair for one party or will not achieve the purpose of the contract, the party requests the people's court to modify or terminate the contract, the people's court shall determine whether to modify or terminate it or not, according to the principle of fairness, and taking the real situations of the case into consideration.

Since its official introduction, the "change of circumstance" in Article 26 of the Interpretation has been applied in a number of cases. To provide an accurate and comprehensive presentation of the current law on the subject, it will be necessary to sum up these cases in the respective section of the commentary of the Contract Law. By reporting and commenting on court rulings in particular cases, in which the laws have been applied to a practical circumstance, the commentary may overcome the shortcoming of the abstractness of the rules both of the laws and of the Judicial Interpretations.

13.5.3.3 Summing-Up Scholastic Views

Last but not least, the commentary book should present an encapsulation of the diverse legal theories and scholastic opinions. There may be opinions on how to interpret an article of a law, or opinions on whether there is a gap in the law and how to fill it. One example in the context of contract law is the third party beneficiary contract. Art. 64 of the Contract Law of PRC is the relevant article, which reads:

> Article 64: Where the parties agree that the obligor shall perform the obligations to a third party, and the obligor fails to perform its obligations to such third party or its performance of the obligations is not in conformity with the agreement, the obligor shall be liable to the obligee for breach of contract.

From a textual reading, it is unclear whether the third party has a right to performance. To ascertain the legal position on the issues, cases and academic writing would provide the necessary materials. Here I would like to make a brief account about the latter. The scholastic opinions are divided into two: one advocates that Art. 64 contains a gap and it does not provide the third party's right to performance; the opposing opinion insists that the expression of the Art. 64 is not perfect and that alone does not preclude the third party from a right to performance. Many methods are used here to conclude that the third party has a right to performance on the obligor, including interpretation by words meaning, interpretation according to system of law, interpretation according to the meaning of the legislator and interpretation by comparative law (Han 2011, pp. 266–271). It is yet to be determined which opinion would prevail under the test of time. The cases and academic writings are still changing and developing on the issue. Yet, it is undeniable that a commentary illustrating the debates concerning the issues would help to move the arguments forward to where a solution could be found.

13.6 Conclusion

To sum up, this chapter has provided a portrayal of the publications that have sprouted after the modern civil law reforms since 1949. Despite the sheer volume of publications in civil law, be it in the form of journal articles or textbooks, commentary literature is lacking the qualities typically found in respected civil law commentaries of other jurisdictions. A large-scale commentary that comprehensively deals with statutory laws, judiciary cases and interpretations and diversified scholastic opinions is much needed and highly anticipated. In the area of civil law, the legal development through legislation, decided case laws and scholastic contributions, has adequately matured, thereby fulfilling the necessary pre-conditions for the publication of an ideal-typical commentary. The task of such work would not be light but it comes with a promise of being a rewarding and beneficial one to all law readers.

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Part V
From Functional Comparisons to Strategic Choice

Chapter 14
Reforming the Reformers: A Different Approach to Access Issues

Linn Hammergren

> The judiciary/court system should be thought of as providing a beneficial function to all citizens at all times... (and) should be guaranteed a basic level of funding to ensure the judiciary exists and is available...
>
> –Comment from a participant in Linked-In blog, Justice Support Group

> "I fear we have adopted a model we cannot afford"
>
> –Comment by a participant in a meeting of Judges from the Pacific Island Countries

14.1 Introduction

I start with these comments because they represent contrasting takes on the topic I want to pursue. While both focus on funding, the dilemma they present goes beyond budgets to issues of how critical services associated with the courts can and will be provided in the future. The first remark, not an uncommon response from judges and attorneys, argues that courts should be financed to meet the demand for their current set of services. Of course, "basic level of funding" is subject to many interpretations (generating their own conflicts), but taken beyond its immediate context (a discussion of court financing), the observation suggests that courts as "the independent crux of a functioning rule of law system", will always be central to how those broader benefits are derived. The comment came in response to a suggestion that user fees be the principal source of financing. To his credit, the commentator also stresses that citizens receive benefits even without having a case in court, through the positive impacts on people's tendency to respect the law and their knowledge of how it will be applied (the shadow effect).

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The second comment, coming from a region where it is probably accurate, suggests some limitations to the first vision. Courts may be central but in the Pacific island countries, the traditional model simply cannot cope with the growing demand for judicial services. This suggests the need for a change in expectations, the model, or, combining the two, greater attention (and funding) to developing additional means for addressing the supply–demand gap. Improving court performance is a logical part of this second vision, just as the use of service alternatives is part of the first. The difference lies in where the emphasis will be placed and which part of the new burden the courts will be expected to assume. There are functions only courts can perform (e.g. providing authoritative interpretations of the law and how it will be applied) and for which their presence will always be essential. However, many others can be performed (sometimes as well or better) in other forums, and the question is whether the courts should continue to absorb them or increasingly let them be handled elsewhere. This also applies to several functions not discussed here (but the subject of additional debates)—running registries, doing notarial work, or managing funds to be paid out to winning plaintiffs (e.g. in child support cases). While only a minority of courts adds these functions, they are often reluctant to give them up, in some cases because they generate income. This is more than an issue of quantity of demand. Notions about effective dispute resolution, the function highlighted here, increasingly call for complementary services (psychologists, social workers, victim assistance) courts have sometimes attempted to provide as well, even to the extent of altering parts of their traditional processes (e.g. a new emphasis by some on mediating disputes). Hence, the "unaffordable" model may become still more expensive thus posing additional threats to the feasibility of its expansion.

Although the second vision is taken from an extreme case, it has broader applicability, and possibly not just for courts although that is my topic here. We live in mass societies where, despite high levels of inequality, there is an expressed desire to make basic services available to all, regardless of their social status and/or ability to pay. Courts and the legal system represent one of those services, and they are also a means for laying claim to the rest. In fact, for some reformers, "access to justice" is not so much about the resolution of ordinary disputes as it is about helping marginalized groups obtain a series of broader social benefits, many of them guaranteed in their respective constitutions, but routinely and systematically denied to the underclasses. This, for example, is an argument forwarded by proponents of "legal empowerment" as seen in United Nations (2008) and in parts of the World Bank's Justice for the Poor (J4P) initiative (Stefanova et al. 2010). The other part of the somewhat schizophrenic J4P seems to favor a reliance on customary dispute resolution or CDR as more culturally appropriate for and acceptable to many citizens (Chopra 2008). I will not go further into this argument or address the issues it raises, only noting that "access to justice" sometimes means just this to its advocates.

Here, "access to justice" is taken to mean access to dispute resolution services, largely dealing with ordinary civil matters. I am also limiting this discussion to third world countries (and principally those regions I know best—Latin America and the

South Pacific and parts of Africa, Asia, and Eastern Europe) with a particular emphasis on efforts by donors to address the issues there. Although many of the issues also affect the developed regions, the solutions adopted there may be different over the medium term if only because, wherever they are invested, there are more funds to finance their implementation.

14.2 Evolution of the Access Issue in Development Work

Providing means to resolve ordinary disputes has always been an important "governmental" function (even in societies without a formal government)—because if left unattended these disputes can have a series of negative consequences ranging from worsening of the situation of the individuals involved to the escalation of their differences into widespread violence. Somewhere in between lie the negative impacts on economic transactions, familial relations, and individuals' ability to conduct their lives without investing significant amounts in hedging their bets—only doing business or conducting non-economic transactions with family and known parties, buying services the state should provide, or relying on savings rather than credit to finance business expansion. When the World Bank and other Multilateral Development Banks (MDBs) first initiated judicial reform programs, these consequences, and especially those with direct economic repercussions, provided the rationale.

More recently, as the MDBs and others have become concerned with poverty reduction, as opposed to sheer economic growth, effective dispute resolution for all, or what is sometimes called the meeting of legal needs, has provided an additional and sometimes preferred rationale for their "justice" work. The argument here is that while the resolution of a justiciable demand for one poor citizen has a negligible impact on poverty levels or growth, where the poor typically cannot resolve their conflicts, the consequences are still greater inequality and thus both continued poverty and less than optimal economic development. This is quite apart from the strong moral argument that any public service should be available on equal footing to all citizens and not only to the better off. Thus access to justice in this sense becomes and has for some time been a part of the overall program for judicial and justice reformers (Blair and Hansen 1994, anticipating USAID's turn in this direction).

The more recent conclusion of many donors that their efforts to help state institutions reform themselves (called a top-down approach) have delivered far less than promised has given a new twist to the access issue. Their detractors claim the reforms have failed in many if not all areas—ranging in the case of the courts, from their ability to improve the quality of judgments, reduce corruption and politicization and increase efficiency to their equitable treatment of and availability to all classes of citizens. Their arguments emphasize access in particular because of the contention that reform works best "from the bottom up", a process that involves mobilizing demand for services from broader constituencies, but especially

typically marginalized or excluded groups. The underlying strategy is not entirely clear, or consistent. For the legal empowerment group, improving services is less vital as the point is to use what is there, flaws and all, to obtain rights for their clients. More traditionally, the bottom-up advocates contend that, left to their own devices and criteria, organizations (or their members) have little incentive to improve services for anyone and will focus "reforms" on their own needs and desires, not on those of their actual or potential clients. At best they may favor traditional court users, but this may further work against the interests of those they never see. For example, adding internet access or the potential for videoconferencing is not much help for the technologically challenged, and can make them still less likely to seek out court services or put them last in line for attention to their concerns.

While indisputable that the poor will only be beneficiaries if their needs are specifically addressed, the notion that a bottom-up strategy will be more effective in promoting overall justice (and occasionally—the empowerment argument—societal) reform remains untested or at least unproven (Van Rooij 2012). It is a little distressing that after two and a half decades of donor-assisted reforms in developing countries, and in the face of some interesting and simultaneous efforts in the developed North, such a conclusion would be reached. Certainly evidence from developed regions suggests that institutional reform, from the top down, can be successful in addressing client needs. There are also examples from the developing world—Brazil's introduction of small claims courts (Sadek 2001); paralegal programs in Africa, Latin America, and Asia; Colombia's Justice Houses; and mobile or itinerant courts, judges and prosecutors introduced in several countries and regions. While donors have financed many of these innovations, they often originate locally. As for the other, less successful programs in developing countries, many of their errors are now well known and well analyzed. There is a large and growing literature on why development efforts in general fail to meet their goals, with some of it focusing specifically on governance and rule of law (Carothers 2003; Hammergren 2007; Kleinfeld 2012; Jensen and Heller 2003). For more general arguments about development see Weaver (2008) and Wrong (2008) as two exponents of the "bad incentives" explanation—members of donor agencies do not do what they often know they should do because their organizations do not encourage it. Whether they lend themselves to remedies is another question, and no more easily addressed than the argument that we need to start over, from the bottom up.

Finally, we have the question as to whether different legal traditions—and especially common versus civil law countries—can find it naturally easier or more difficult to respond to these concerns. The legal traditions argument began in the context of commercial cases and was widely disseminated by the World Bank's Doing Business publications. It has a counterpart in criminal justice—with the work supported first by USAID to make Latin American justice systems "less inquisitorial" and more "adversarial."

While Doing Business and its standard recommendations (simplify, cut times, reduce costs; see World Bank 2005) survive, its attachment to common law has

suffered sufficient criticism to put it into eclipse. However, at least in Latin America the anti-inquisitorial campaign continues alive and well although less overtly associated with the common versus civil law argument—in part because its caricaturized models have little real world basis, and in part because the Latin Americans have created a system based on ample, if often imperfect imitations of practices associated with both traditions. Except for the criminal justice claims that only an "adversarial" model guarantees an effective defense, when necessary subsidized by the state, neither variation of the legal traditions school ever addressed access issues. I of course find this claim preposterous and can cite many counter examples in both directions. However, I mention it as the only example I can find in the literature linking access to legal traditions. It bears noting that the two traditions differ largely in how they provide legal services to parties unable to retain their own lawyers—with civil law countries more likely to pay private attorneys rather than creating an army of salaried public defenders. Moreover, civil law systems tend to expect judges to play a more active role in assisting unrepresented parties, a need long ignored in countries like the US. Conceivably Doing Business's standard recommendations (especially lower costs and less time) might enhance access, but Doing Business was never focused on the problems of the poor. Thus, there is not much to go on for further exploration, and as someone who believes the entire legal traditions debate has been overblown and for the most part laid to rest, I don't plan to do much with it either. There certainly are differences in how easily countries manage top-down or bottom-up reforms, in general and as they relate to access, but to the extent legal traditions explain them, there are arguably more within than between-tradition differences, some of which are mentioned below.

In the following pages, I want to suggest and lay out another thesis entirely—not that top-down or bottom-up approaches, or common or civil law traditions are better or worse in meeting new demands, but rather that a focus on access may provide a more productive manner of addressing the two vision quandary presented above. This issue, relevant for all countries, but especially for the developing world, questions how far the traditional court model can be pushed to take on increasing demand for dispute resolution and changing notions of what dispute resolution should involve. Starting with access forces us to ask what services are important, how and to whom they are already provided and with what consequences, and how these patterns might be improved. The answers and reasoning are somewhat different for criminal and non-criminal matters, and thus the parameters set by the Louvain symposium make the task easier.

Latin America: Civil Law Tradition and Common Law Procedures?
Latin America is firmly within the civil law tradition, but since the late 1980s its countries have heralded the adoption of adversarial, oral criminal proceedings, presumably more in line with the common law tradition. By now

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virtually every country in the region has adopted new substantive and procedural criminal codes, starting with Guatemala in 1992 and most recently seen in Mexico where constitutional amendments enacted in 2008 require compliance by 2016 on the part of all states and the federal government. Similar changes are now contemplated throughout the region for civil justice and its various sub-categories.

Despite the announced aim of this region-wide movement, its departure from the civil law tradition is less marked than proponents claim. First, this is being done through codes, very much in line with civil law practices. Although common law countries increasingly rely on black-letter as opposed to judge-made law, they typically use court rules and individual laws for what civil law countries put in a code. Second these codes are based in their form and much of their content on civil law models (either the pre-existing national code which rarely disappears entirely, the model Latin American code authored in the 1960s by regional experts, or newer European codes). Few common law jurists have participated in this process (given their lack of practice in code writing) except in suggesting certain specific modifications based on their experience in their own countries. Third, and as a consequence, many of the details are more in line with practices in Germany (where two of the early supporters, the Argentines Julio Maier and Alberto Binder, had studied) or elsewhere in Europe. These include provisions for extensive (and what most common law practitioners might consider excessive) prosecutorial supervision of the police investigation and the strict prohibition on the same judge overseeing the pre-trial and the trial phase of the proceedings. Where juries have been adopted (in very few countries) the European mixed jury seems to be the preferred model. Inclusion of US-style plea-bargaining has been attempted, but not in its "purest" form which is deemed incompatible with the defendant's due process rights. Meanwhile the potential for prosecutors to conduct mediation between the victim and the accused is more compatible with European trends. As countries move into civil justice reform, the emphasis on "orality" may exceed practices in either civil or common law countries and seems to be based on a Latin American belief that oral hearings afford more transparency and access for less educated citizens.

Common law countries, and especially the US, have had an impact on other details: the adoption of the US model of public defense (an organization in its own right with salaried attorneys), the widespread use of US-style, free-standing alternative dispute resolution in civil matters, and the adoption in some countries (most notably Brazil) of the US small claims court, featuring simplified proceedings (usually a single hearing) and pro se representation. Since the US remains the most active donor in code implementation, its prosecutors and defenders have had considerable influence here, sometimes,

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unfortunately, recommending practices inconsistent with the new laws. In any event, the codes as written and practiced represent a Latin American mélange of elements taken from both traditions as well as an often imperfect elimination of some older vices. Especially in countries with more problematic justice systems, participants in oral trials often work from written scripts, neither judges nor lawyers effectively control abusive tactics, hearings are excessively long and frequently cancelled, and the quality of public defense is suspect. Once Latin Americans realize they have invented their own model, they may well have more success in making it work, but for that to happen, as it has in a few countries, they will have to pay more attention to what the codes cannot change—weak, poorly structured institutions with little oversight over the behavior of their own members.

14.3 Understanding the Access Issues as Currently Addressed

14.3.1 The Basics of the Problem

The challenge involved—how to provide dispute resolution services to a greater portion of the population—takes several forms and over time has been addressed in a variety of ways, none of them completely satisfactory. The fundamental issue here is poverty, of both societies and their citizens. Unfortunately, both types of poverty tend to coincide. A state with many poor citizens, often 50 % or more of its population, is also less likely to have abundant resources to attend to their needs. Being poor does not mean one has fewer disputes; it simply means one will have greater problems in finding ways to resolve them and will face disadvantages when pitted against an opponent with access to more resources that can be used to bolster his/her/its claims. Inequality is thus a secondary issue; even as societies become wealthier and especially as they move from low to middle income status, the disparities in the distribution of income and wealth tend to increase until and unless adequate redistributive and social safety net programs can be implanted, again a question of resources. Although the Latin American and Caribbean nations, nearly all within the middle-income group, have recently made progress in reducing inequality, the region as a whole retains the highest levels of inequality in the world. Following a period of rising income inequality (the 1990s), the Gini coefficient for Latin America and the Caribbean fell from 0.529 in 2000 to 0.509 in 2009. The decline has been documented in 13 of the 17 countries for which comparable data are available (López-Calva and Lustig 2012). As the authors further note, this occurred during a period when inequality was rising in other parts of the world.

The poor and other marginalized groups are not the only ones affected, but they do face numerous exceptional barriers in accessing courts and other state sponsored services; thus removing these barriers has been an initial emphasis of access programs everywhere. The focus has been on the access part of the phrase with the question of the more specific benefits enjoyed ("justice") left unexplored or subject to various interpretations. In fact, for bottom-up advocates, getting people to court is often seen as the best means of resolving issues of service quality and so should precede or make unnecessary efforts to improve the latter. An early USAID rule of law framework (Blair and Hansen 1994) thus put "institutional development" after "constituency building", law reform, and "access" in its sequenced strategy.

The focus on barriers has evolved over time. First to be noticed, even prior to the donors' arrival, are the impediments of physical distance and usage fees. Both are most problematic for the poor as they are least likely to live close to state service units (courts, prosecutors' offices, and so on), to have the ability to pay for transportation, or to have funds for legal (and often illegal) fees. Thus, the simple answer has been to build more service units, distribute them more broadly, and reduce or eliminate charges according to ability to pay. Unfortunately, the simple answer becomes more difficult to implement as overall poverty increases. Poor countries already have fewer judges and courts, worse transportation facilities, and little ability to subsidize users' access to either. Still with donor help or on their own many nations have managed to expand services to underserved urban and rural areas.

Second, even if "free" of fees, there are additional costs (hiring a lawyer, paying for other services like getting access to documents including but not limited to archived records and case files). Although some countries have expanded the use of *pro se* (self) representation, finance legal assistance programs, and allow the waiver of fees for inability to pay, the ample use of these opportunities is often restricted in part because those who might benefit from them do not know of their existence. As a Latin American lawyer once explained to me, a client needs legal assistance to know fees can be waived and to prepare the request. In a World Bank (2003) study in Argentina, which does allow the waiver of fees, researchers found this occurred in only 1 % of the cases filed. The poor are also less likely to understand the basic procedures for filing and defending a complaint (or defending themselves against one), they are often, with good reason, fearful that judicial and other biases will work against them, and are least able to withstand the multiple visits and long delays often required to take a complaint from filing through its final resolution. As a better-off opponent usually understands, delay is a potent weapon that can be manipulated to force the other party to desist or accept a cut-rate settlement. And it is not only the opponent who can take advantage of this. In Honduras it was reported (USAID/ARD 2009) that lawyers representing poor employees in labor cases often bought the right to litigate (and recuperate any winnings) for a risible sum. For someone dismissed from a job, waiting 2 years for a judgment may simply be impossible. Although Brazil's labor courts tend to favor the employee in the first instance, employers increasingly threaten an appeal as a means of negotiating a reduced award (World Bank 2004).

Third, there are also significant cultural and social barriers to access, which do not originate with the courts or other dispute resolution mechanisms (administrative agencies, alternative dispute resolution services, even some customary mechanisms). Winning or prevailing in a rightful claim may still involve significant costs in terms of future relationships with the other party or with the community as a whole. Critics of Ethiopia's new family legislation noted that it was developed by urban residents for urban situations, and that helping women to obtain a divorce overlooks the difficulties a divorced woman would face in a rural community (World Bank 2010). Winning a case against an employer could ruin one's chances of getting another job in communities where employment is scarce, or in the event of reinstatement could lead to further difficulties. A series of labor sector assessments financed by USAID discuss many of such disincentives (USAID/ARD 2009). A World Bank study of nomadic groups in Northern Kenya found some of them attempting to withdraw criminal complaints because they saw little point in a victory that would result in the guilty party being locked up; compensation or restitution even for serious crimes struck them as more useful (Chopra 2008). Especially in multi-ethnic societies, notions of a fair outcome often vary, and what is offered by the state institutions may not satisfy many disputants.

None of these barriers are unique to developing countries, but their greater incidence and impact there have led to a search for alternative means to resolve the justice issues faced by poor citizens in particular. Solutions have gradually evolved from an effort to provide free legal assistance (often only feasible so long as donors foot the bill) through the promotion of free standing and court annexed alternative dispute resolution, and legal information services (for issues that may not involve litigation) to the use of paralegals and "judicial facilitators", a term introduced in an OAS program funded by several bi-lateral assistance agencies for usually unpaid volunteers trained to help judges deal with simple cases, often by offering mediation, not unlike programs initiated elsewhere, for example the mediators sometimes attached to Brazil's small claims courts or Colombia's virtual army of equity conciliators, some of whom provide services in that country's Justice Houses. Also, the rediscovery of customary dispute resolution emerges as not only an alternative but possibly as a preferred solution. As we will see, while this does provide means to resolve disputes, there are many caveats as to how well this is done and with what consequences. Still more recent innovations involve the addition of special services for poor parties involved in common disputes, whether aired in court or through alternative forums. These include assistance to victims of domestic violence, job training, various kinds of social services, and so on. Rather surprisingly, some courts in developing countries already facing supply–demand gaps for normal services have attempted to add these programs. Donors have also financed their provision by legal service NGOs. This clearly goes beyond dispute resolution and what courts have traditionally been expected to do, but it has become a part of the access paradigm. Finally, in several Latin American countries a sort of affirmative action program for poor clients who do get to court has been forwarded. This is most notably the case of Colombia and Ecuador, and less formally in Brazil through the "Robin Hood" thesis. Ribeira (2006) explains the thesis as understood

by some judges, but also argues, based on an analysis of judgments, that even those convinced of its value usually do not apply it. This kind of affirmative action has no legal standing unlike Colombia's constitutional requirement for a "differential focus." Called the "differential focus" in Colombia and figuring in its Constitution (Article 13 although not under this name), it requires special treatment for the poor and disadvantaged users of any public service and seems to imply special consideration for the weaker party to a dispute. The most visible impact on courts and other dispute resolution forums is the use of interpreters for those not fluent in Spanish, redesign of facilities to accommodate the handicapped, and the expansion of the public defense and mediation services. How the differential focus affects judgments and whether in fact it does is unclear.

14.3.2 The Problem of Costs

The issue is not all about money, but costs obviously count, not only as a barrier to access, but also as an obstacle to breaching this and other barriers. Funding is a universal challenge, but presents greater impediments in the developing world. Providing more services to more citizens requires more investment, both in efficiency promoting measures, and once these have reached their limits, in increasing the number of service providers and service units. Countries vary considerably in how far they have gone, or are willing to go, on the first track, but for many developing nations, both tracks will clearly be needed. These also are the countries where the issues are most problematic given the large proportion of poor citizens, lower public budgets (because of a narrower tax base and inefficient collection agencies, as well as sheer poverty), and a variety of chronic weaknesses of their justice systems. Moreover in much of the developing world, simple logistical factors add complications. Few countries may be in the situation of Kiribati (80,000 inhabitants scattered over 30 islands in an expanse of ocean the size of the continental United States) and several other Pacific island countries, or some of the larger African nations (Democratic Republic of the Congo, Ethiopia, Nigeria) with widely dispersed, largely rural populations, but even in countries like Colombia (46 million) much of the 25 % of the population classified as rural lives in areas where provision of any government services is spotty at best. For these countries, or these citizens, the issue is less the efficiency or quality of court services than simply getting to a judge in the first place. A recent study of state-financed legal services centers (called Justice Houses) in Colombia, found that in rural counties 90 % of users came from the population center where the House was located. Rural dwellers might still have to travel 5 h by foot or mule to get to the House, and the roads were so bad that sending the staff to them has proved equally impossible (USAID/MSD 2012).

Courts everywhere typically receive only a small portion of the public sector budget (whether provided through general taxes or user fees—sometimes called "own resources" although they are just as "public" in origin as the taxes collected

by a revenue agency). Likewise their percentage of the total GDP is very small (CEPEJ 2005, 2006, 2008). Getting a good handle on total financing for courts or other justice sector agencies is less easy than it sounds—in part because their budgets may be handled by various agencies (split among the court themselves, a judicial council, a ministry of justice, and possibly a public works agency that manages infrastructure and equipment purchases), in part because what is meant by "court services" also varies from country to country, and in part because of the role played by various voluntary actors (including non-professional judges as in the UK, but also in many developing countries, *pro bono* assistance from professional and non-professional actors). However, regardless of these complexities of detail, it appears that the amounts are universally small and that we are quibbling over a percentage or two of the overall budget and fractions of a percentage of the overall GDP. Nonetheless in an era of overall belt-tightening across the public sector, these percentages or fractions of percentages can be important, both in terms of adequate service provision and a government's willingness or ability to provide more. It also bears mentioning that in Latin America, these percentages, if not the absolute amounts, already reach some of the highest levels in the world—6 % of the public budget for El Salvador's courts and 2–3 % for several other countries—and yet services remain poor and limited access is a constant complaint.

Costs of expanding access to traditional services involve more than the supply side of the equation (paying for more judges and courts and placing them in more locations). Removing other obstacles to access also raises funding issues. Among these obstacles is the fact that the traditional court model has generally assumed the parties' use of a lawyer to orient them and represent their arguments. With the exception of anomalies like the UK, where the budget for legal assistance is considerably (three times) higher than that for the courts, most countries spend significantly less on subsidized legal assistance. Again, actual budgets are often hard to define, but when one considers sheer numbers of state-financed lawyers around the world, it is clear budgets are far lower than for other elements of the sector (and especially courts, prosecution, and even lawyers defending the state in its own cases). For example, both Malaysia (which could afford more) and Ethiopia (which clearly cannot) only provide state-subsidized legal assistance for defendants in capital cases (World Bank 2010 and 2011). Colombia, now with one of the largest legal defense services in South America, still has only half the number of defenders as judges and only slightly more than half as compared to prosecutors. Moreover, it hires most defenders through annual contracts and allows them to carry for profit work as well. Outside of the developed regions, virtually no country provides lawyers for ordinary civil cases. Costa Rica has tried, but is not able to cover many, and Colombia, while incorporating services for victims of crimes and displaced persons, still has trouble providing assistance to all indigent defendants. *Pro bono* contributions by private attorneys, donor-financed NGOs, and the increasing acceptance of *pro se* representation take up some of the slack, but in the developing world, hardly fill the gap.

Despite the popularity of alternative dispute resolution (ADR) mechanisms, they also have costs and someone must cover them. There have been many experiments

with voluntary mediators but over time, they tend to disappear because of the costs incurred by the service providers—or alternatively, as has happened with those attached to Brazil's small claims courts (Sadek and Batista Cavalcanti 2002 at pp. 9–10), because they eventually demand a salary. As with other "free" and *pro bono* services there are also concerns about quality; these range from volunteers giving less attention to their unpaid work to their potential misuse of their positions. Whether workers are paid or not, ADR programs are often poorly monitored because effective monitoring also requires funding. Costs and quality are concerns for nearly all the other innovations—information services do not operate for free, paralegals must be compensated for their expenditures (transportation, supplies) and most probably need some remuneration for their work, and of course additional social services, special provisions like interpreters, and handicapped-friendly buildings require financing. While many of the alternative, if not the additional, services are said to be most cost-efficient, that is not entirely clear. On the one hand, their real caseloads are often fairly low, and on the other there are questions as to their success in clearing them. While not an alternative service, Colombia's public defenders provide one example; studies indicate that the number of cases they handle for the state (as opposed to those they accept for fees) is relatively low (USAID/MSI 2010). On the other, getting a real handle on costs for such services may be more difficult than costing out the formal system. A recently completed study on Colombia's Justice Houses (USAID/MSD 2012) found it virtually impossible to determine how much is spent on them, as most of their services depended on part-time work by employees of other local and national agencies and the rest came from volunteer mediators and student interns.

14.3.3 The Issue of Vested Interests and Entrenched Practices

Costs are only one of the impediments to improving access. Others arise in two very strong incentives for keeping things as they are: habit and self-interest. An inefficient, inaccessible, biased, and even corrupt dispute resolution system has its backers. These are the individuals who have learned to work with it and to a greater or lesser extent benefit from its very flaws. Self-interested benefits are always a factor, but disinterested habit should not be discounted as a disincentive to change. All those engaged in an on-going system have established practices, rhythms and rules of thumb they have developed over time. Judges learn to deal with traditional clients—it is more difficult to handle the new ones with new demands, different expectations, and an incomplete or null understanding of basic processes. The growth of pro se representation in the US is causing problems for judges who must learn to make allowances for those working without lawyers—this takes more effort and may lead to errors (Judicature 94:5, March–April, 2011, 204). In many developing countries (and I am sure I will earn few friends with this remark) judges do not work that hard and a sudden increase in demand may alter their expectations about their own lifestyle. Observers (including those sent out from the courts) often

comment on rampant absenteeism, judges' delegation of their own work to office staff, excessive adjournments, inefficient docket management, and inexplicably long delays in drafting responses to motions. However, even where they are already putting in long days, the new demands can seem impossible to answer.

Use of alternative (customary or modern) mechanisms also runs into a variety of conflicting interests—ideological, self-serving, or a resistance to breaking with established habit. In Latin America, after some initial resistance, ADR has now been widely accepted by the legal community, largely because they have found a way to insert themselves into the process, and where not, seem to see the loss as minimal. Like legal assistance programs, ADR can represent a solution to the employment problem of many lawyers, especially if the state agrees to pay for their services. In regions where there are few lawyers (much of Africa, the Pacific region) there is little resistance inasmuch as no one, judges or lawyers, sees this as anything but a plus. However, *pro se* representation is still an issue and has been combated in several countries. It often occurs as a matter of course, but the idea that this would be the norm in some courts cuts into the legal community's interests. Moreover both this and the acceptance of CDR have ideological opponents who fear that the resolutions reached would breach various international standards—the right to an attorney or the recognition of specific human rights conventions. However, so long as it does not involve more work for the already fully occupied or cut into the employment opportunities of those who are not, the use of alternative mechanisms other than CDR probably faces its biggest obstacle in the reluctance of potential users to try them.

14.3.4 Are We Getting Closer to Resolving the Problems?

The access advocates have been extraordinarily inventive in finding new ways to get citizens to court or to alternative forums. Since in developing countries, many of these innovations exist only on a pilot basis and are often donor funded, there are some legitimate concerns as to what is called scaling up—taking the pilot nationwide. Moreover, as happened earlier with many top-down programs, their purported success is so great as to raise questions of credibility. In a world, or country, where enforcement rates for judgments are frequently under 45 %, is it conceivable that those for negotiated agreements are over 75 %? And then of course, there is the issue of the fairness of the mediated solution. While hardly a representative sample, the author has seen several that look fairly suspect in this regard. Presumably if both parties are happy, that is all that matters, but there is the question of whether the one who lost most understood that "under the law" she/he was entitled to much more. Laying aside this issue, there are still legitimate concerns about the outcomes. They include (1) whether the agreement will stick because both parties understand its contents; (2) whether it will be respected over time or give rise to further conflicts (as things like child support are not or should not be a onetime payment) and (3) what happens when the "loser" figures out what the law would have provided.

If one purpose of dispute resolution is to end the conflict and avoid recurrence, some alternatives to formal justice may not fill the bill. Similarly, some formal solutions may also leave the dispute unresolved in the sense that the losing party is not satisfied and may raise the issue again in another form or take still more drastic action.

It is also well to keep in mind that dispute resolution is only one of the courts' functions. In this regard, ADR and CDR exhibit another weakness—they may provide solutions to individual disputes, but they usually leave no public record of the remedies, and thus do not perform another basic court function (for a well-functioning court of course) of enhancing juridical certainty or the shadow of the law effect. For many issues this may not be necessary; the law is already clear on the outcomes and the negotiation will only be over the details of how or how much I will pay, for example. But one reason for not submitting complaints to mediation or some similar mechanism is that the law needs further strengthening or clarification (Genn 2010). Here, those who fear the eclipse of the judiciary in the face of the various alternatives can take consolation. Some disputes are too important for essentially private resolution, and the question thus turns to how they can be identified for judicial treatment. Reiling (2009) offers an interesting analysis of how such decisions might be reached, based not on content but on the predictability of the outcome and the parties' interest in cooperating.

14.4 Taking the Access Issue Apart: Elements of a Different Approach

Most access approaches have focused on providing additional mechanisms for facilitating court use or alternative means for resolving disputes. Access advocates of all stripes have been extremely innovative, but perhaps have focused so much on access that they have neglected the "to what" question, or answered it only as a forum for dispute resolution. Without entering into the never-ending debate as to what is "Justice" one might instead start with a question as to what needs are being resolved, and even there go beyond the resolution of the individual dispute to the presumed larger social benefit of fewer escalating conflicts. For individuals the issue is clearly a satisfactory resolution to a problem; for the society it is fewer problems resulting from unresolved disputes. Is there a way to combine the two ends? The following suggests a different approach to getting at that answer.

14.4.1 Legal Needs

A focus on defining legal needs has its origins in the developed world, where the term may be far more accurate. An entire methodology has been developed based on the Grossman et al. (1982) naming, blaming and framing pyramid and usually

starting by asking people whether they have encountered any one of a series of common problems—with employment, with marriage, with social security and so on (Genn 1999). Despite a claim, again originating in the developed world (HIIL 2012; Genn 2010) that the most common legal needs are similar worldwide, once one digs beneath the shared title, the nature of the dispute and its justiciable or legal character may vary widely. What we are concerned with in the developing world are disputes or conflicts, which may or may not be considered "legal" or "justiciable" depending on the legal framework itself, and where, even if susceptible to legal treatment the likely remedies may well not satisfy either party. This is not simply a question of the zero-sum nature of most legal remedies (and thus the claim that negotiated solutions are inherently preferable in many cases) but also of different notions of what is fair or just.

Access advocates have often assumed they know which disputes count and why. Moreover donors have still another cut on the matter, arising in issues of interest to their constituencies back home. Having been asked to address how well Colombia handles Roma issues (35,000 of the country's 46 million inhabitants and arguably only noticed when women dressed in Roma outfits solicit money on the main streets of Bogota) or whether a program in the Pacific region addresses LGBT (Lesbian, Gay, Bi-sexual, and Trans-sexual) concerns (with little notion from those asking the question of what those might be) I find myself wondering how firm a handle access promoters have on why it might be important to citizens in general, and the poor in particular. There is little question but what unresolved disputes can evolve into major societal conflicts, but before one attempts to address them, it may be well to understand better what they are, what their importance is to those affected, and whether and how they are being addressed.

A final caution should be added on the legal needs methodology. Both the survey methods and the specific questions asked can have enormous effects on the reported levels of "unmet needs" and the problems giving rise to them. The differences can go in both directions—extreme under or over reporting of both incidence and significance. A recent survey (Black et al. 2011) done for the Center for Disease Control and Prevention (CDC) thus reported annual levels of rape and related sexual violence in the US far above (nearly ten times for rape) those captured in the National Crime Victimization Survey. Critics claim this is a consequence of how questions were asked and interpreted, contending that the CDC's results were influenced by the advocate groups contracted to conduct it (Washington Post January 29, 2010 A13). Whether true or not, the case illustrates a broader point—that different surveys in the same country may produce very different results, just as the same survey applied across countries may attract responses more reflective of cultural differences both in respondents and surveyors than of the "real" situation. Certainly "legal needs" studies add information not captured in a review of what courts receive—tapping disputes or problems that do not get that far. However, the significance of these findings requires careful interpretation if they are to guide further policy.

14.4.2 Origins of the Problems: A Place to Start?

If, as the claim goes, the most common disputes are a universal phenomenon, the form they take, their importance to those affected, and the immediate reasons for their occurrence appear to be less so. Employment, family matters, real property (including tenant matters as well as property rights), and "monetary" claims (usually debt) may head the list everywhere but the more specific nature of the disagreement, of the claims and of the impacts does vary.

Employment claims often head the list at least among urban respondents. Since most surveys don't extend to rural areas, doubts may be raised as to their importance there. In fact, in a survey of over 6,000 clients of Colombia's Justice House program (ADR services for the rural and urban poor, USAID/MSD 2012), employment disputes came in far behind family issues (a ratio of 1–3 as opposed to the "normal" 2–1). Moreover, notions, legal and otherwise, about employment rights shape the nature of the dispute. Here common versus civil law traditions and other purely cultural factors do play a role. No one likes to lose a job, but "unfair" dismissal is far harder to claim (and prove) in the US where the notion of a right to employment stability is the exception (largely restricted to the public sector) rather than the rule. The civil law tradition tends to be more protective of the employee, and developing countries following it have tended to adopt the presumption of stability as well—leading, it is often argued, to employers' reluctance to enter into formal contracts, a greater reliance on outsourcing (cheaper but also less legally threatening), and in the accompanying absence of any kind of unemployment insurance, the dismissed workers' recourse to the courts as their only resort. Colombia follows this tradition (with all the accompanying problems), but as the survey shows, among the poor, the legal basis for a contract rarely exists, meaning first that employment disputes are rarer than supposed and second, that they are likely to take other forms—a dispute over "monetary matters," or simple debt. They may also feature demands with no basis in anything except employee needs. Recent research for an unpublished study on Colombia's labor sector found workers in soon-to-be redundant jobs seeking retraining or job creation programs from their employers, a responsibility with no legal basis but for which the workers saw no other solution.

This example also raises another point. Disputes begin with "problems" but only become disputes when the source of a solution can be identified. Sometimes this identification is automatic and supported by law, but sometimes it is only the result of the affected person's desperate search for someone or something that might provide a remedy, whether legally responsible or not.

Family disputes may be another constant but one that takes different forms depending on local law, parallel normative frameworks, and other contextual variables. Norms about marriage, divorce, property rights, inheritance, custody and child support vary widely, and also take different forms in traditional societies where extended families may assume some of the usual burdens and also be parties to any negotiation. As a consequence, while the concrete "needs" may be similar, not only the remedies but also the claims vary, across and within societies.

Monetary claims and especially debt collection seem to be another standard feature, but with considerable variation as to their causes and the form they take. Individuals and corporations will unavoidably sign contracts they cannot fulfill or offer a level of compliance unacceptable to the other party. When this happens they typically negotiate a solution, and if this doesn't work go to a court or another dispute resolution forum. The situations become more complex when such agreements involve individuals from different backgrounds with consequently different understandings of the elements and force of a verbal or written contract. A study done in Mexico (World Bank 2002) on summary debt collection cases found that many small debtors did not understand the implications of contracts they had signed, especially as regards interest—which during the 1990s often involved variable rates that might quickly assume proportions far in excess of the principal. Another frequent obstacle incurred by consumers of bank and public utility services is that probably illegal fees and charges are often too small to warrant hiring a lawyer to contest them. Courts in Rio de Janeiro, Brazil, thus added a "court-door" mediation service to handle the most common of these disputes (World Bank 2004), seeking to benefit both court users and those who "lumped" the issues because standard remedies were too costly.

What is often included under land/tenant disputes also varies greatly as regards claims and the underlying causes. In developing countries, ownership of real property is a more common dispute but again for a variety of reasons—prevalence of squatter settlements in urban areas and also on large tracks of virtually abandoned rural land, political events causing displacement of rural and some urban residents and thus multiple claims by those who have occupied the land/building sequentially, issues involving use, distribution and even sale of communally held lands, and questions as to subsoil rights, something probably never contemplated in founding understandings of what ownership means. The law may cover much of this in theory, but not in a way that matches popular understandings or even the current situation. Hence here the dispute may be first over what a right means, and only secondarily over who holds it. Landlord-tenant disputes tend to be a more modern phenomenon and one again influenced by the civil versus common law tradition with the former according more protections to the tenant. However, as with other land issues, the underlying dispute may be less over who has the right than what the right is—disputants' sense of what is just may be out of sync with the law, or vice versa.

Finally, while moving beyond the realm of purely civil matters, there are numerous disputes that arise over administrative issues—governments claiming moneys from or prohibiting actions by citizens, and citizens claiming services from government that have not been delivered. These may be uniquely a problem for the relatively more developed—largely because the contact between government and citizens is so restricted in the very poorest countries. However, as this contact increases, the disputes it generates seem to grow even more rapidly. There is also a phenomenon, best tracked in Latin America, of conflicts caused by governments' failure to provide legally and even constitutionally guaranteed services and benefits. However, recent complaints about the US Office of Personnel Management's

(OPM) delays of up to a year in regularizing pension payments does raise questions as to whether this is only inefficiency (as OPM claims) or something more akin to the Latin American control-the-cash-flow tactics. Where governments' promises exceed their resources, administrative agencies may engage in long delays, sub-standard service and payments, and other systematic efforts to control their cash flow. Some of these disputes end up in court where they are usually resolved on a one-by-one basis, often with further delays (in part because government agencies may refuse to cooperate with the legal action). However, like the consumer issues mentioned above, individual remedies rarely provide sufficient incentive for the agency to halt the practice. Moreover, public sector entities are often the worst offenders are regards honoring a judicial decision. As one Mexican administrative judge told the author (interviews, Mexico City 2009), if you are trying to recuperate money from the government, you might receive the principal, but obtaining fines and interest may require another legal action.

All of these disputes either enter the courts or some other dispute resolution forum, or, unless resolved independently by the parties, lead the latter into further problems. Expanding dispute resolution mechanisms is one way of addressing these issues, but where these disputes are common and arise in known causes, there may be other methods to decrease their incidence—a prevention strategy as discussed below. This patently is not the job of the courts, but the courts could be advocates for such solutions since unless they are effected, the judges end up with the consequences in the form of an increased caseload. Of course in anything less than an ideal world, prevention will not be easy and certainly will not be total, but there are some steps that might be taken.

14.4.3 Means for Satisfying Common Disputes

Another preliminary question, often not addressed before some strategy is designed, is how disputes are currently handled and whether existing mechanisms exacerbate or resolve them. A further question is whether the resolution is fair, but as we have seen above, fairness is very much in the eye of the beholder, and here that eye should be first and foremost that of the parties, and secondarily, that of society—which may have a vested interest in assuring certain outcomes and the incorporation of certain standards. What the donors believe comes in third in relevance, but if donors don't like the outcomes resulting from the first two criteria, they can always withdraw.

As one example, there seems to be no question but what land disputes are common in many countries, although as discussed above, they take different forms (and thus possibly require different solutions) according to the context. In Africa and the Pacific island countries, much land is held communally, distributed by the communal authorities, and over time questions may evolve as to who the latter are and over which lands they hold control. Moreover, as land has been commercialized (for use in urban areas, for resorts or for expatriate homes), further

conflicts have arisen over the effective permanent alienation of holdings. The land often cannot be alienated/sold permanently. However, in the Pacific islands, long-term leases with a clause requiring the owner to pay for any improvements before resuming control provide for effective alienation (Stefanova et al. 2010). Commercialization is a separate problem requiring inter alia better information and advice to those giving out long-term leases, but "ordinary" communal disputes do have a means of resolution. In the Pacific region, it is long, often first heard by customary or hybrid courts and then subject to appeal to the formal system, but the very length of the process is said to be an advantage—giving everyone both a chance to speak and to cool off. One doubtless could find more expedient means for reaching a decision, but the process, as lengthy as it might be, seems to satisfy most parties. There certainly are exceptions but as in Africa, they seem to involve other issues—ethnic conflicts, movement of populations from area (or island) to another, claims to subsoil rights and so on.

The efficacy of traditional remedies in resolving traditional disputes should not be discounted. They fall short, however, when standards, conditions, or the nature of the conflicts change. Land disputes, even over communal land, have become more frequent in many countries because of population pressures and the higher values put on some lands. This has also (Ubink 2008; Ubink et al. 2009) had negative effects on some traditional systems whose authorities may begin to give themselves rights and powers beyond those they theoretically hold. However, the same is often true of formal law and formal institutions in the face of rapid social change.

14.4.4 The Role of Lawyers

A shortage of lawyers is often associated with developing regions, and in many instances is an accurate depiction. Ethiopia with possibly 2,000 attorneys in private practice for its 80 million inhabitants or Malawi with roughly two dozen (for a population of nearly 15 million) certainly illustrate that situation, as do many other African countries. However, these conditions are not universal, and while their geographic distribution may be as skewed as that of courts and prosecutors, most Latin American countries have a reasonable supply of attorneys in private practice. This situation may soon extend to other middle-income countries for much the same reason; individuals seek a professional degree to improve their own circumstances, and a law degree is often the easiest to obtain. It also is the most profitable for universities to provide, as it requires little investment—as one Latin American critic noted, only a classroom and a few lecturers (literally "a guy in a suit and tie"). The author heard descriptions of similar developments, a proliferation of private law schools of dubious quality, during interviews in Romania (May 2012). As the number of lawyers increases, however, they find it more difficult to make a living owing to the poverty of most potential clients. This has not stopped them from trying and the role of the coyote or *chicanero* (as the less honest practitioners are termed in Spanish) in fleecing poor clients in particular (but also others) is well known

In poorer countries with larger complements of attorneys, there is typically a segmented employment market—elite lawyers at the top serving better-off clients and often earning fees comparable to those in more developed regions, a midlevel serving middle class clients, and a large number of underemployed professionals who make do as they can. All of them have invested time and money in learning how to operate in the courts and with out-of-court legal matters, and thus add two elements to the definition of dispute resolution needs. First, lawyers are naturally inclined to prefer legal processes for dispute resolution, as that is their background and the source of their income. Second, where the competition for clients is stiff, they will be inclined to turn any dispute into a legal matter rather than recommending other means of resolution. Practicing attorneys have often opposed the introduction of alternative dispute resolution, the use of paralegals, and the introduction of pro se representation, until and unless they find a means of inserting themselves into the new procedures. The OAB (Brazilian Bar Association) has fought against the pro se proceedings introduced by the courts for social security and other small claims. The OAB's leaders, largely elite attorneys, have no direct interest here, but to keep their organizational positions, they need to placate the other members who may indeed feel threatened by the expansion of the pro se opportunity.

Lawyers also play a role in shaping assistance policy, as most donors seem to believe they are the natural experts in the justice sector. Unfortunately many lawyers, and especially the young idealists often attracted to this work, see litigation as the natural way to resolve disputes and for that matter any social problem. Their second choice may be law, but largely law that facilitates litigation, not law that might short-circuit the conflicts, and while many lawyers in developing countries are increasingly enamored of mediation, this rather surprisingly tends to be less interesting to the donors' legal experts. I do not want to over generalize as there are many exceptions, but donor activists, of the legal and other persuasions, tend to see disputes as an invitation to do battle, rather than as problems that might be avoided. While some of the strongest critics of the top-down approach, they may also be one explanation for its many failures—given a no-holds-barred, no-prisoners-taken approach to combating whatever evil they identify in the societies where they work or the judiciaries they are supposed to assist. While common law practitioners are presumed to be more adversarial, this outlook is hardly limited to them.

14.4.5 Conclusions on the State of Access in Current Donor Assistance

For the various reasons cited, enhancing access to justice, especially for the poor, has become a central theme of donor assistance. Amounts currently spent on programs may not reflect its importance, but most donors seem interested in giving

it more room. Given how donor assistance operates, a certain time lag is inevitable, but the shift to bottom-up assistance and access approaches seems to be the wave of the future. Significantly, for the legal traditions aspect, this trend and the activities associated with it do not seem to vary by the civil or common law background of either the donor or the counterpart nation.

Looking at what donors have done and are proposing, it is not evident, however, that they will be any more successful in this new orientation than they were with their traditional programs. Their focus on access still privileges getting people to court or alternative services and providing them with tools and assistance to make them more effective in presenting their cases. However, it does not go beyond this to ask whether disputes will be resolved more satisfactorily and whether as a result, levels of conflict will be reduced. This is the lawyer's strategy—level the playing field and let them have at it—to which I am offering an alternative, public policy approach to addressing the issue of conflict and how to reduce it. This is still access and it still privileges the poor, but it takes a different definition of the problem to be resolved.

14.5 A Three-Part Approach to the Access Issue

Roughly speaking developing countries can be divided into three groups according to their level of financial and other resources for addressing access issues. The three-part approach discussed below depends for its further application on where each country sits in this grouping:

- Countries that can afford to put judges, prosecutors, and police within reasonable distance of all populations and monitor their performance, although providing subsidized assistance for all but criminal defendants, will be difficult. For non-criminal cases, these countries can also finance paralegals, ADR, and the programs needed to facilitate pro se representation and should be able to fund monitoring systems. CDR may also be used but only by relatively small groups of inhabitants who prefer it to state services of any type. Many Latin American countries fall into this group, as do some of the more developed African ones and parts of Eastern Europe, Asia, the Middle East, and North Africa.
- Countries where the ability to place the above actors within all regions is currently limited by costs and absence of adequate numbers of suitable professionals, but can be expected to grow over time. In the meanwhile, their use of the above alternatives and of CDR, where it exists, may incorporate some monitoring systems, but nothing as rigorous as possible for the first group of countries. Many African countries and parts of Latin America and South East Asia may lie here.
- Countries where the ability to do most of the above will be limited over the foreseeable future because of costs and logistical complications. The Pacific island countries and others, especially in Africa, with widely distributed populations (if over a land rather than ocean area) are classic cases.

The approach, anticipated with some of the comments made immediately above, combines top-down, bottom-up and prevention as a three-part strategy. Which part is emphasized, hinges largely on a country's resource base, the types of disputes encountered, and our understanding of their origins. Thus, a first step, before introducing any of the following is to collect more information on disputes, their causes, and the current means of resolution as well as their consequences. Once that information is analyzed, a three-part approach to dealing with the most important, ordinary disputes can be designed and implemented.

14.5.1 Improving Court Performance—A Modified Top-down Approach

Part of the answer to how to improve access involves improving court performance. This is the equivalent of medical "curative" approaches for disputes that have already occurred. I put this first to emphasize that it is not forgotten, but also because despite the criticisms of past efforts, it arguably is the easiest to implement, assuming one is willing to learn from past mistakes.

To decrease court congestion, make room for new demand and new clients, and improve their treatment several mechanisms are recommended, although they will be most necessary and most feasible in the more developed nations. They include:

- Measures to increase court efficiency—legal change to simplify proceedings, introduction of small claims courts with pro se representation (and training of judges to handle this); monitoring of caseloads, backlogs and clearance rates to encourage judges to keep up with their work; and redistribution of judges and court units to match real and projected demand.
- Case purging exercises to eliminate backlog, and especially long inactive cases.
- Case diversion exercises and other measures to reduce court caseloads to what courts should handle (real conflicts with uncertain outcomes, largely of the zero-sum type). Non-prioritized or excluded cases encompass three categories: those diverted to ADR or left for CDR; those sent to administrative agencies, and those rejected for lack of merit (but allowed to seek out other forums should the complainants so desire).
- Introduction of itinerant judges, mobile courts, and some technological innovations (videoconferencing, on-line filings and even on-line judgments for simple cases).
- Additional measures to improve service quality, including anti-corruption programs, training where indicated, and publication of judgments (for transparency but also as an incentive to do them quickly and well).

The above obviously are all natural candidates for top-down reform, but most development assistance has avoided nearly all of them in favor of providing judges with what they want, often only to make their lives easier but not necessarily to

improve the service to their clients. A focus on access (getting more clients to court for cases only courts can handle) thus puts a premium on service improvement. This has been absent from most top-down approaches—the problem is not the top-down methodology, but rather the goals and strategies chosen. The reasons are numerous but essentially stem from the difficulty of getting courts to recognize their own shortcomings. It is far easier to provide assistance based on the argument that inadequate service is a consequence of what you didn't have (equipment, buildings, training), not what you didn't do (reorganize your processes, focus on results, work more intelligently and more diligently). Donors, even those giving grants, need agreement from their counterparts; the trick is to get them to agree to something that is essentially difficult and moreover may require admitting some shortcomings.

If court services are to be improved, attention will also have to be given to facilitating use, through a combination of legal assistance, opportunities for pro se representation and training of judges to deal with these clients, and court-annexed mediation services. Where feasible, pro bono services and NGOs can also help, but will require monitoring for quality. State or donor financing of these activities should also follow the indications of the initial assessment. This should prioritize the most common disputes, not the ones of most interest to donors or specialized NGOs. Amazingly, while family disputes often get attention (and should in most cases), donors seem to ignore landlord-tenant, debt and other monetary claims, and even employment issues, possibly because they find them less interesting. Their attention to land issues has been greater, but hardly systematic, largely focused on titling (hardly the solution for communally held land or for many other disputes) or on defending the rights of indigenous populations dispossessed of lands they once occupied.

Here a word may be said on the ease of introducing these changes in civil and common law countries. In the developed world, the difference seems minimal. We find excellent innovators in both legal traditions and both seem equally amenable to a service orientation. In the developing world there may be some differences owing to:

- The ability to use court rules to make many changes in common law countries that would require an act of parliament in the civil law tradition.
- In many civil law countries, the relatively lower status of judges—recruited young and thus without the prestige of a lengthy, private career behind them. This may make them more adverse and even less able to tangle with attorneys and overrule some of their outrageous practices. However, similar phenomena are seen in many common law Pacific island and African countries, where the few lawyers may go into private practice, leaving the courts to depend on lay magistrates or less qualified attorneys who are easily cowed by the "elite lawyers."
- Possibly a greater emphasis on legal formalism in the civil law world, although there is certainly much of the same in the developing common law community. One has only to look at the wigs on many judges and lawyers in tropical countries, or the retention of formal language even eliminated in the UK to recognize that formalism is also alive and well in the common law world.

These differences only suggest the presence of more openings for this type of reform in a common law system. However, the numerous examples of countries that have not taken them make it clear that an opportunity is no guarantee that things will be done. Two other factors, seemingly independent of the specific legal tradition, are leadership and a certain amount of top-down control. Chile, a civil law system, has been successful with its efficiency reforms largely because of its judiciary's hierarchical organization (and the good luck of having chosen an administrative director with a management outlook). Some of the more successful common law developing countries (Singapore, Malaysia, Ethiopia) also have a hierarchical organization and less insistence on judicial independence (which in all other respects would be considered a flaw). However, in this regard, see Peerenboom (2005) and others who recommend what they call the "Asian model" of addressing efficiency first and independence second.

14.5.2 Incorporating Alternative Mechanisms More Appropriately

It is increasingly recognized that not all disputes are most satisfactorily handled by courts. More regulation may make more disputes susceptible to court treatment, but this is no longer considered the only or best way to deal with them. The danger, often raised in developing countries, but also in developed ones (e.g. the compulsory arbitration clause in many US credit card and other contracts) is that one may be creating a second-class dispute resolution system, which also incorporates certain biases against the less powerful. The same is also true of a reliance on traditional mechanisms, whether purely customary or based in religion.

Nonetheless for many poorer countries, or those with other contextual problems (populations widely dispersed and thus out of the range of state services), alternative mechanisms are likely to be the default choice for some time to come. This may be a matter of convenience as much as of citizens' preference for traditional values. It was reported, for example in Vanuatu, another small Pacific island country with widely dispersed populations, that women with child support cases sometimes withdrew them from the "hybrid courts" which presumably might be more favorable to their demands, instead preferring a quicker decision forthcoming from the traditional authorities (Women's Crisis Center, Port Vila, Vanuatu, 2011). The hybrid courts use traditional leaders but more formal procedures, thereby as one person noted, combining the worst of two worlds—bias and delays. Just as an entrepreneur might prefer a faster, if less favorable decision to winning a case over several years, the women were willing to take their chances in a more biased forum in favor of a quick response.

One problem with modern ADR as introduced in many third-world countries is that its superiority to custom is often assumed rather than tested. Many problems have been documented—ranging from pressuring parties into a mediation process

they do not want, to mediating cases that legally should not be handled this way (e.g. in many countries, domestic violence). Other issues involve having the presiding judge offer to mediate first—raising the fear that those who refuse to comply will be judged more harshly if the case is adjudicated. Mediation is clearly beneficial, and like CDR may be the only practical response to demand in many countries, but it needs to be monitored as closely as the courts to ensure the standards of quality and quantity (cost efficiency) are met.

While some of this will be addressed in the next section, alternatives also incorporate more than ADR and CDR—extending to administrative processes, settlement (negotiations between the parties without a third actor), and possibly incorporating some of the additional "court" services in both their traditional and modern forms. Reforming administrative agencies may in many countries still be more difficult than reforming courts, but for both dispute resolution involving their activities and some of the additional services of both kinds (traditionally, registries and document certification, and more recently, various social services) they are arguably the ideal providers. Turning over to courts everything administrative agencies do poorly or asking courts to perform purely administrative services is a distortion of the judicial function. Courts can aid in promoting administrative improvements, assuming the legal framework provides adequate sanctions and grounds for defining administrative malfeasance. Doing so involves not only a reconsideration of court functions, but also as discussed in the next section, sufficient time to implement the transformation.

14.5.3 Preventive Measures

A medical analogy for the justice process is hardly unusual, but is commonly limited to the "curative part"—what happens after the problem has occurred. This has provided support for ideas about paralegals (like paramedics or nurse practitioners), evidence-based diagnostics and remedies, and even epidemiological approaches to handling crime. Very little has been done, however, with an obvious part of the medical scenario—to prevent problems before they happen or for that matter, with a third element, the decision to do nothing to avoid the risks of adding more complications. I am not elaborating on this here, but it is implicit in the earlier discussion of legal needs and a focus on significant problems. At least in the United States, the medical profession has also tended to overlook this option, because of, as critics charge, a notion that "they have to do something." Possibly a similar bias affects those working on access. True, on the criminal justice side, there is a growing focus on prevention. It includes much of what donors now call "citizen security projects," community-based policing and social services to help residents fight crime in their neighborhoods and provide youth-at-risk with the skills needed for legitimate employment. However, little attention has gone to non-criminal matters. Elite corporate attorneys do consider this a part of their role—steering their clients away from "problems waiting to happen." The growing use of legal

insurance in many parts of Europe can be thought of as another prophylactic measure, but rather than avoiding problems, it like health insurance is aimed at financing their legal resolution. For countries and clients who cannot afford any of these quasi-preventive, quasi-curative means, there may be a way of addressing disputes as preventable occurrences on a broader scale.

As with crime prevention, reducing the frequency of disputes is a long-term proposition. It is also a far more complicated task than simply facilitating their transfer to courts or alternative forums, but in the end, the social benefits can be greater. As with crime or disease prevention, the more reasonable policy goal is not total elimination, but rather a focus on types of disputes and causes that are more easily controlled. Candidate measures would not address the underlying origins (for which more complex policies will be required), but rather practices and policies that tend to exacerbate their consequences—the functional equivalent of things like early bar closings, restrictions on gun possession, and hotspot policing with a proven impact on the incidence of certain types of crime.

Where the opportunities lie is highly contextual and thus the following are offered only as illustrative examples.

Employment: A good part of employment disputes arise when someone loses a job and seeks compensation (or reinstatement). The ideal policy solution—employment generation and unemployment insurance—was already out of the range of the possible for most developing countries, and is more so in an era of higher unemployment and stretched public budgets. However, there may be some more practical means to reduce the level of conflict without seriously harming the interests of either employees or employers. In developing countries, much of the legal framework governing employment relations is long out of date and for a variety of reasons covers only a small part of the labor market. Those entering into a legally defined employment relationship may have ample benefits and protection, but especially in countries with large informal sectors, the majority of workers are not covered. The nature of employment and the needs of both workers and employers are changing rapidly, and efforts to extend the coverage of outdated laws are arguably not the solution, and in any event will only generate more conflict and more efforts to circumvent them. Instead, taking into consideration what is often at stake—for workers "decent work" and access to pensions and other social benefits, for employers a dependable workforce with the right skills—a few simpler changes might be considered.

First, employment laws might be redrafted to enhance the potential for long term, non-permanent contracts and the entire notion of "core functions" (blessed by the International Labor Organization) abandoned as an archaic concept. The idea here was that certain functions are critical to an enterprise and thus must be filled by permanent employees. While this may have made sense several decades ago, present day enterprises constantly change their "core functions" and thus their need for specific kinds of employee skills. Given the presumption of stability, employers in many countries use what even for them may be second best solutions: outsourcing, a series of interrupted contracts (a month or two before renewal so as to break the sequence), and sequential hiring of different employees for the same

job (interestingly, some international organizations, including the World Bank, have long used these tactics for just this purpose, and are now encountering problems in some of the countries where they operate). Second, such solutions also deprive workers of other benefits because they are still linked to the job and so raise the ante as regards retaining a position against all odds. Speeding up policies to delink social safety nets from employment and make pensions and health insurance transportable (linked to the individual and not the specific job) would aid here as well. In short, while employment will always be a source of disputes, the prevailing legal framework can exacerbate their occurrence. With a few changes, which admittedly will not be easy to effect (but more for ideological reasons than for the costs incurred by anyone), many employment disputes could be eliminated or at least made less daunting.

Monetary claims: This covers a broad spectrum of disputes so only a few will be treated here. A first problem is that the weaker party to a contract often does not understand what she/he is signing and even if she/he does sees little alternative. This suggests considerable room for consumer education and also for some state monitoring of common contracts (for credit cards, purchases on installment, mortgages and so on). This will be opposed, but may be easier in civil law countries where the state's right to interfere in the public interest may be less easily contested. Second, throughout Latin America (and by extension possibly in other civil law countries) summary debt collection is hardly summary and often involves a long and complex legal process (World Bank 2002). Were courts, as they do in many Western European countries, to treat the usual issue as simple validation of a right to collect (based on a valid contract or its equivalent), much of the incentive for delaying payment would be eliminated. Instead, where debtors have liquidity problems, services for negotiating payment or refinancing might be provided. Third, as demonstrated by the Brazilian examples cited (World Bank 2004), private providers of public services (credit, public utilities) often take advantage of their ability to make many small mischarges, counting on the victims' decision not to pursue a small claim. Stronger sanctions against such practices (including those indulged in by government agencies) might help to reduce their incidence. In all three cases, we are treating systematic and often well recognized abuses by debtors or by creditors. Disputes could be reduced by attacking the practice rather than waiting for them to get to court or some alternative mechanism.

Administrative claims: These are becoming more common in many developing regions, and thus generating more business for the courts. Brazil's federal courts have created innovative mechanisms for addressing disputes over social security payments, including pro se representation and automated processing of claims. One judge estimated that in 75 % of the cases heard, there was really no dispute—only an underpayment of what was legally owed (World Bank 2004). In interviews in Colombia in 2011, knowledgeable observers held that the underlying problem for most pension cases (representing roughly 60 % of the caseload in ordinary labor courts) was systematic underpayment of claims. There is clearly a problem here as there is with many other claims arising in alleged government failure to deliver

services or benefits. However, it originates in government policy and resources. Letting it become a dispute and sending it to the courts for "resolution" is a second best solution although one understands why governments might prefer it.

The Latin American *Amparo*—a Mixed Review for Dispute Resolution
The *amparo*, a writ of protection from alleged violations of constitutional rights, was invented in Mexico, but as used there, offers few benefits to the poor—largely because it requires specialized and costly legal assistance. However, as adopted in other Latin American countries it has become a very potent instrument for those seeking remedies, especially in countries like Costa Rica, Colombia and Ecuador where it can be presented without an attorney and often in verbal form to any judge. Its use against court judgments is more controversial and is not considered here. *Amparos* (or their functional equivalent—the name changes from country to country) have been used extensively and successfully to protest administrative abuses or failure to deliver guaranteed services. In countries where the state is unable or unwilling to enforce its own laws, it may be the only way citizens can access their rights. The downside is that the *amparo* usually only offers a remedy to the individual complainant and thus that the quantity of *amparos* entered adds to court congestion and results in a highly inequitable distribution of benefits. As has been suggested by some judges receiving these and constitutional writs with broader effects, it might be more efficient to insist on better administrative responses. However, for a state short of resources, the *amparo* clearly offers the benefit of avoiding its wider commitments while still providing the appearance of relief. Although their services are often not required, many attorneys have begun to make a business out of encouraging and facilitating *amparos* thereby further complicating the situation.

Some of the other disputes addressed above (employment, even family issues) can also be traced to poor performance by administrative agencies, or government's inability or unwillingness to enforce its own laws (or commitments). The first best solution clearly lies in policy, not in court actions, or at least not in court actions to resolve individual disputes arising from administrative inaction. A further problem with individual relief is that it usually costs the agency only what the complainant requests. There are generally no further sanctions and thus no disincentives for continuing the objected practice.

14.6 Conclusions

In presenting an alternative use of access issues to improve judicial reforms, I have suggested that there are valuable elements of both top-down and bottom-up approaches, but that their effective application hinges first on defining the goals

in a broader fashion. It is not simply expanding access to dispute resolution, but resolving disputes that matter most to citizens and to the extent possible working to prevent disputes that arise unnecessarily because of how certain problems are handled. As in the case of crime, prevention of non-criminal disputes will probably not attack their underlying causes (e.g. shortage of "decent work," excessive pressures on available land). Doing this requires more complex policies, really the essence of development. However, there are often some relatively simple changes that can be made to laws and ordinary practices that can reduce the incidence of some conflicts, which whether or not resolved, only complicate people's lives and relationships. Here semantics and program titles get in the way. Justice programs focus on courts or their equivalents, and access issues are defined as facilitating dispute resolution. No one involved in these programs on either the side of the donor or the country defines their work any more broadly, and many of them lack both the perspectives and the skills to operate on that basis. There is clearly much that can be done to improve dispute resolution from the access angle, but I want to suggest that a broader take on the underlying problems (origins of the disputes) is a useful addition to our understanding of our jobs.

The use of these perspectives and mechanisms is legal-tradition neutral as are in fact the more conventional approaches to expanding access. Country resources and cultural preferences (only some of them linked to either legal tradition) count for more, but as the limits of traditional models, even in the most developed systems, become apparent, the need for innovative alternatives is common to all. We already have examples of countries from both traditions, rising to the challenge. If this can be done more systematically, and the lessons learned disseminated in the context of a broader discussion of the shared problems, both developed and developing countries could share in the benefits. Unfortunately, development assistance seems to be behind the curve on these issues: it behooves it to catch up.

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Chapter 15
Financial Crisis as a Catalyst of Legal Reforms: The Case of Asia

Masahiro Kawai and Henrik Schmiegelow

15.1 Introduction

The financial crisis in emerging Asian economies in 1997–1998 was triggered by massive capital outflows, which followed equally massive capital inflows that had taken place in the mid-1990s. These capital inflows had gone to domestic financial firms—mainly banks—and corporate sectors of the affected countries (Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand). The Japanese banking crisis of 1997–1998 was caused by the collapse of the real estate bubble, which affected banks that had extended excessive bank loans to the corporate sector with real estate as collateral.

The financial crises in emerging Asia and Japan adversely impacted banks and corporations in these economies. Most banks were heavily burdened with large nonperforming loans (NPLs). A large number of corporations had levels of debt they were unable to service and investment assets that were economically nonviable. The holes in the balance sheets of banks and corporations were huge, and it took many years to write off problem loans and failed investments.

Bank and corporate restructuring was an essential element of the strategy for sustainable recovery and growth in crisis-affected economies. Restoring a healthy banking system was necessary to ensure an adequate supply of credit to support economic recovery. Corporate debt and operational restructuring was the key part of this exercise as a healthy banking system required credit-worthy corporate borrowers. The crisis-affected countries learnt that bank restructuring and corporate

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restructuring needed to take place simultaneously as the banking crisis was rooted in systemic insolvency problems in the corporate sector.

One of the most significant impediments to bank and corporate restructuring in these crisis-affected countries was the lack of systematic—particularly legal and institutional—frameworks that would enable problem banks to be resolved quickly, weak banks to be rehabilitated, financial and operational sides of viable corporations to be restructured, and nonviable corporations to be put into insolvency procedures. Bank and corporate restructuring required reforms of substantive as well as procedural areas of law. Substantive legislation was needed in the areas of antimonopoly, banking, bankruptcy, insolvency, and commercial law. Judicial systems had to provide for credible enforcement of contract law in civil or commercial courts, effective bankruptcy courts, and the creation of procedures for out-of-court workouts. There was considerable variation in the six countries' paths toward crisis resolution, reflecting differences in their economic and legal development. Nonetheless, there was a remarkable commonality in the policy actions to create the enabling legal environment for both immediate crisis resolution and more sustained economic growth and development. The experience of the six Asian countries offers useful lessons for crisis resolution and legal reforms in other regions of the world.

One of the main objectives of this chapter is to describe how the financial crises in emerging Asia and Japan worked as a catalyst for legal reforms in the crisis-affected countries in Asia. The responses of six Asian countries with different legal histories to financial crises that posed similar challenges are of both legal and economic interest. Another important objective is to examine whether the legal reforms have improved the quality of legal institutions in these six Asian countries. It would be expected that the reforms would have had a positive impact on the quality of legal institutions. From this perspective, we examine a few indicators that measure the quality of legal institutions—such as regulatory quality, rule of law, and control of corruption. This approach can help refocus the debate on the relationship between law and economics as well as on methodologies for measuring the impact of legal change.

The chapter is organized as follows. Section 15.2 provides a theoretical presentation on the debate on law and economics. Section 15.3 reviews the basic approaches adopted by the Asian countries affected by financial crises in 1997–1998 to bank and corporate restructuring and to legal and institutional reforms in economic and other areas. Section 15.4 considers these issues from country-specific perspectives. Section 15.5 analyzes indicators of the quality of legal institutions, examines whether the quality of such institutions has improved following reforms of substantive laws, and interprets the findings. Section 15.6 concludes the chapter.

15.2 Relevance for the Debate on Law and Economics

Although the causes of the financial crises in the five emerging Asian countries and in Japan were different, they triggered simultaneous reforms in one or more areas of law: (1) business governance, (2) credit and security interests, and (3) dispute settlement. For scholars of comparative law, the similarity of these legal reforms is all the more remarkable in view of differences between the legal histories of the six countries. These countries were similarly affected by the financial crises, irrespective of their categorization as civil law or common law countries, which poses a challenge to legal origins theory. Empirical approaches to linking law and development might consider the financial crises as salutary external shocks forcing entrenched legal systems to open up to necessary change. In institutional economics, business governance, credit and security interests, and dispute settlement play important roles in supporting the legal environment for economic growth. Analysis of the catalytic nature of the financial crises that triggered reforms in these three areas can help deepen the understanding of the mutual relationship between legal reforms and long-term economic growth and development.

15.2.1 Comparative Law

Apart from Malaysia, the countries examined have legal systems featuring civil codes, commercial codes and civil procedure codes, and are commonly, if not always entirely correctly, referred to as civil law countries. The three codes cover substantial parts of business governance, credit and security interests, and dispute settlement, unless legislation of business and banking sets special norms. Of these countries, three—Japan, the Republic of Korea, and Thailand—legislated their codes autonomously, although borrowing selectively from patterns of the European codification movement in the nineteenth century. Malaysia is the only common law country in our sample.

When Japan began its modernization in the second half of the nineteenth century, there was a prolonged struggle between Japanese scholars advocating French, English or German models. A composite of French, English, German, and traditional Japanese patterns prevailed (Tanaka and Smith 1976). With its civil code of 1896, its commercial code of 1897 and its civil procedure code of 1890, Japan became the leading example of the voluntary selection of elements of Western law from the perspective of comparative law. Berkowitz et al. (2003) emphasize that this type of voluntary adoption of foreign legal patterns, as opposed to colonial transplants of legal systems, correlates with a high degree of effectiveness of legal institutions. However, after World War II Japan's banking and corporate sectors were profoundly transformed by laws modeled on American statutes. The Antimonopoly Law and the Securities and Exchange Law are the foremost examples of this transformation. While adjusting these new rules

continuously to changing economic requirements, Japan has fared remarkably well with them. Rather than being governed completely by either civil law or American models of business laws, the spectacular growth of Japan's post-war economy was supported by what might be called strategic pragmatism (Schmiegelow and Schmiegelow 1989).

The Republic of Korea, which became independent in 1948, adopted a civil code in 1958, a commercial code in 1962 and a civil procedure code in 1960. All three codes were drafted by Korean legal scholars educated in the systematic foundations of the Japanese codes. But the result was distinctive in substance and style (Kim 2000, 2008; Kozuka and Lee 2009). Thailand had a more protracted debate on the choice between continental European law and English law. It began in 1892, when English law had strong support, as many jurists had been trained in England. Nevertheless the legislature decided in favor of continental European patterns, except for the area of sales law, where English law exerted strong influence. The code of civil procedure was enacted first in 1908 (Boonyawan and Phetsiri 2011), and the civil code and commercial code followed in 1925 (Schwenzer et al. 2012).

Indonesia and the Philippines received their civil law systems by colonial transplant, Indonesia from the Netherlands (Tabalujan 2002; Deguchi 2008) and the Philippines in the sixteenth century from Spain and then American common law principles after the American–Spanish war in 1898, transforming the Philippines into a "mixed jurisdiction" (Villanueva 1990; Sicat 2007). Berkowitz et al. (2003) attribute the slower pattern of historical per capita GDP evolution in Indonesia and the Philippines in comparison with that in Japan, the Republic of Korea and Thailand to the "transplant effect" of the imposition of a culturally foreign legal system on a non-receptive country where local customary traditions had previously prevailed (Tabalujan 2002; Gamboa 1974).

Malaysia adopted the common law system through legislation on British Indian models (Hamzah and Bulan 1995) in contrast to prevailing perceptions of the English common law tradition as a legal system based on judge-made law. The entire common law was codified in the late nineteenth century as part of the British effort to accelerate its diffusion in the British Empire (Badami and Chandu in Chap. 7). Intellectually, this effort was guided by the perception of cultural incompatibility between English common law and "native" legal traditions (Wilson 2007). Just as in the cases of former colonies of civil law countries, the "transplant effect" may explain why Malaysia, despite rich natural resource endowments, did not develop as rapidly as countries with autonomous codifications, such as the Republic of Korea. The economically most important codifications of the common law under British rule were the Civil Law Act of 1937/1956, the Contracts Act of 1950, and the Subordinate Courts Act of 1948. After independence in 1957, Malaysia continued using the same technique of legal reforms with the Banking and Financial Institutions Act of 1989 and a series of civil procedure statutes. These included the Courts of Judicature Act of 1964, the Subordinate Court Rules of 1980, the Rules for the High Court of 1980, the Rules of the Court of Appeal of 1994, and the Rules for the Federal Court of 1995 (Ahmad and Rajasingha 2001).

Hence, from the perspective of comparative law and legal history, there is a difference in the relevance of the legal reforms induced by financial crises for the affected countries. While legal reforms were undertaken in crucial areas in all six countries, such reforms were particularly relevant for the autonomous development of legal institutions in the three former Western-colonial countries (Indonesia, Malaysia, and the Philippines) as these countries moved away from transplanted legal systems.

15.2.2 Legal Origins Theory

Legal origins theory (LOT) argues that common law is economically superior to civil law (La Porta et al. 2008). Authors advocating the theory focused on the comparative performance of financial markets in New York, London, Paris, and Frankfurt in the 1990s (La Porta et al. 1997, 1998). They looked for behavioral patterns and legal rules encouraging the provision of capital to financial markets (Shleifer and Vishny 1997; La Porta et al. 1997, 1998). Their most influential thesis is that common law encourages uninformed capital owners to trust professional insiders acting as agents in the best interests of their principals, whereas civil law is the expression of the will of the ruler rather than of free citizens wishing to protect their economic interests (La Porta et al. 1999). As explained in Chaps. 1–5, the most important contribution of LOT, however, was to marshal impressive resources for cross-country econometric analysis relating the economic performance of more than 170 countries of the world to their legal origin in one of five categories: English, French, German, Scandinavian, and Socialist. This effort was unprecedented and remains unrivaled until today.

Having initially focused on substantive rules governing financial markets, such as shareholder protection in corporate law, authors supporting LOT subsequently found common law to be superior to civil law in the procedural field as well. Assuming that common law was close to the ideal of two parties informally entrusting their dispute to their common neighbors' judgment while civil law procedure was inefficiently formal, Djankov et al. (2002, 2007) associated civil procedure in civil law based countries with long duration and low transparency. In fact, leading American scholars of comparative law as well as reformers of English civil procedure have arrived at the opposite conclusion, lamenting the time and cost inefficiency of common law procedure as compared with civil law procedure (Langbein 1985; Jackson 2009). The lower mean and median values of the duration of common law procedure are obtained only in large country samples with overwhelming majorities of economically struggling former colonies, more than half of which are coded as of French legal origin. These samples capture lagging development rather than the intrinsic qualities of common law and civil law (Schmiegelow, Chap. 5).

Unfortunately, the theory's methodological problems are severe. Static cross-country analysis with large numbers of countries may have the advantage of

econometric robustness, but cannot capture evolutionary change such as legal and economic development (Schmiegelow 2006; Armour et al. 2007; Boucekkine et al. 2010; Deakin and Sarkar 2011; Docquier 2013). The classification of countries into one of the five categories is so inaccurate on the comparative law level of analysis that it may seriously undermine the value of theoretical conclusions for policy. The three most revealing examples of this problem are: (1) the categorization of the US as of English legal origin, although its business laws and financial regulations are essentially codified in civil law style rather than judge-made as in English common law (Dam 2006); (2) the listing of Japan as of German legal origin, although its civil and commercial codes are syntheses of French, English, German, and domestic patterns, and its banking and corporate laws are inspired by American models; and (3) the classification of practically all Latin American countries as of French legal origin (Dam 2006; Schmiegelow 2006). The Philippines, with its hybrid Spanish and American legal system, is labeled as of French legal origin. So is Indonesia, arguably with more reason, as the older Dutch codes transplanted in the nineteenth century were inspired by the Napoleonic codes. But Thailand, which codified its civil, commercial, and procedural codes autonomously like Japan without being a colony, is categorized as of English legal origin (Djankov et al. 2002, Table 2A). Malaysia is the only country of the six countries considered in this chapter, which is correctly categorized as of transplanted English legal origin.

Djankov et al. (2007) recognized the incapacity of static analysis to capture evolutionary change but still maintained the defective country codings of the 2002 paper and the cross-country analysis for most of their 129 countries covered. Using data reported by the authors, the average of the duration of enforcement (271 days) for the four countries of our sample coded as of civil law legal origin—Indonesia (570), Japan (60), Korea (75), and the Philippines (380)—is shorter than the average (345 days) for Malaysia (300) and Thailand (390), the two countries coded as common law legal origin.

Even though there are some grounds to support LOT, its relevance for the analysis of bank and corporate restructuring in Asia is generally limited. Alternative dispute resolutions are clearly preferred whenever necessary and possible in countries with less than efficient judicial systems. The fact that both the impact of the financial crises on the economies of the six countries and their catalytic roles for legal reforms cut across the common law and civil law divide in Asia is one more methodological challenge to legal origins theory.

15.2.3 Law and Development

Debate on the relationship between law and development has gone through wide swings. Two waves of US and international efforts at legal reforms in developing or transition countries in the past five decades were each followed by protracted debates on the relative merits of top-down approaches working with governments

and judiciaries of countries in need of legal reform versus bottom-up strategies relying on nongovernmental initiatives in favor of the rule of law, access to justice, and poverty reduction (Hammergren 2012). The first wave occurred in the "development decade" of the 1960s and was aimed at modernizing legal systems in developing countries. As described by Trubeck and Galanter (1974), it was based on the assumption that the American legal system was good and potent and thus should be exported to developing countries. The trough followed in the 1970s when American legal scholars, after exposure to more sustained contact with lawyers and scholars in developing countries, began to realize that their assumption was questionable in terms of foreign policy, economics and jurisprudence. The second wave was driven by the surge of optimism after the fall of the Berlin Wall. Again, large American resources were mobilized, this time directed at rewriting the legal systems of Russia, other former members of the Soviet Union and Eastern European countries. The trough came when prominent advisors, who had gone on their missions with great faith in the early 1990s, became appalled later in the decade by evidence of moral hazard in voucher privatization and the "kleptocracy" of prominent Russian entrepreneurs (Black et al. 2000).

A collection of empirical studies on the rule of law (Jensen and Heller 2003) analyses past failures of rule of law programs and highlights evidence of resistance of entrenched judicial sectors to structural reforms within and across legal systems. It concludes by advocating that structural reforms should rely on competition and incentives for altering existing legal practices and institutions, as they remain artifacts of the very system that is the object of reform. Perhaps this view does not sufficiently recognize the role of legal scholars, legislators and judges in the history of legal reforms since the transition from feudal societies to modern contract societies in the nineteenth century (Maine 1861). Japan's and Thailand's early autonomous modernizing codifications and the post-independence reforms in Indonesia, the Republic of Korea, Malaysia, and the Philippines are part of this history.

Heller (2003) is certainly right to draw attention to the importance of institutional competition and incentives for reform, especially in transnational and supranational integration processes and in functional interaction with multilateral organizations. He could have added one more type of incentive for legal reforms: financial crises such as those discussed here. Such crises are disruptive directly for the affected economies and potentially for entire societies. If the legal systems concerned rose to the challenge by adjusting through structural reforms, it would be a sign of at least some adaptive functionality of these systems. The crises would be used as catalyst of legal reforms and subsequent development.

15.2.4 Institutional Economics

The most compelling relationship between law and economics is observed if law reduces transaction costs as shown by Coase (1937, 1988) in his theory of the firm as a system of long-term contracts and by North (1981, 1990) in his studies of

constitutions, property rights and other laws as frameworks providing order and safety to markets. For example, secure property rights are a necessary condition for the accumulation of physical and human capital, which played a crucial role in the "East Asian Miracle" (World Bank 1993). Boucekkine et al. (2010) show how codified default rules for the economically most important contract types reduce transaction costs for incomplete contracts and correlate with economic growth for eight developed or newly industrialized economies, including Japan, the Republic of Korea, and Taipei, China since the time of codification.

Pistor and Wellons (1999) analyzed the same three areas of law that were challenged by the Asian financial crisis of 1997–1998, i.e., those related to business governance, credit and security interests, and dispute settlement. They retraced the relationship of these areas of law with three contributions to growth in Asia between 1960 and 1995: (1) capital formation, (2) lending volume, and (3) division of labor. They studied a set of six Asian countries different from the set concerned here, but overlapping with it partially as it included Japan, the Republic of Korea, and Malaysia. The relevance of analyzing the challenge of the same three legal areas posed by financial crises in the set of affected countries should be evident.

15.3 Issues in Bank and Corporate Restructuring

15.3.1 Impact of the Crisis on Growth

The Asian financial crisis of 1997–1998 devastated the economies of Indonesia, the Republic of Korea, Malaysia, and Thailand and adversely affected several neighboring countries including the Philippines. The crisis—a combination of currency and banking crises—was driven by rapid capital inflows followed by equally rapid outflows. The banking sectors of the affected countries played a critical role in intermediating large amounts of domestic savings and external, foreign-currency-denominated short-term funds for long-term domestic lending of dubious quality, thereby creating the "double mismatch" problem and the potential for banking crises. The countries' corporate sectors, which had expanded both debts (domestically and externally) and domestic investments, faced difficulties in repayment when the currency values began to decline sharply.

Japan's banking crisis in 1997–1998 was domestically driven; it was a result of the collapse of the asset price bubble in the early 1990s and the lack of a decisive comprehensive strategy to address the banking sector problem at an early stage of the asset-price bust. The asset-price bubble in the late 1980s had been created by the optimistic expectations of ever-rising land prices in Japan, an overextension of bank loans to corporations with land as collateral, the absence of a credit culture to assess and price credit risks of borrowers rigorously, and weak macro-prudential supervisory frameworks. Slow policy responses allowed a systemic banking crisis to emerge in 1997–1998 and led to the resulting long-term stagnation.

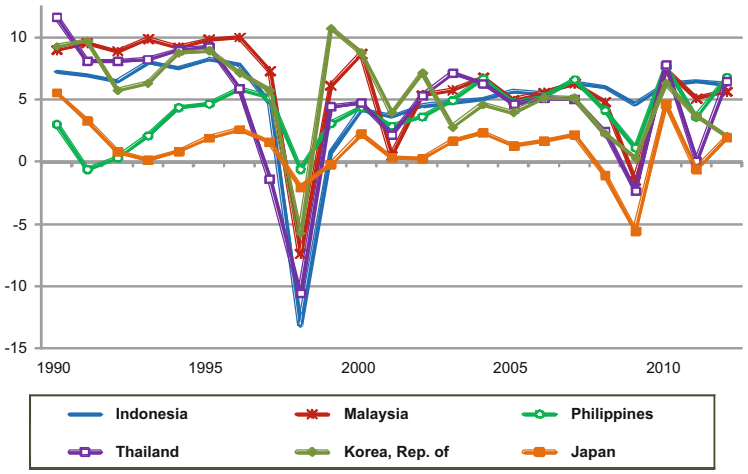

Fig. 15.1 Real GDP growth performance for crisis-affected Asian economies. *Source*: IMF, World Economic Outlook database (October 2013)

The crisis-affected emerging Asian countries saw a sharp contraction of economic activity in 1998 (Fig. 15.1). GDP growth in the five crisis-affected emerging economies of Asia—Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand—declined sharply from a pre-crisis average of positive 7.1 % during 1990–1996 to negative 7.6 % in 1998. The depth of the collapse in Indonesia, with GDP contracting by more than 13 % in 1998, was among the largest peacetime contractions, excluding the experience of several transition economies in the early 1990s. Japan's decline in GDP growth was more modest than those in emerging Asian economies—except the Philippines—but its GDP growth remained low afterwards. The concurrence of economic contractions in the affected economies in 1998 was remarkable.

The contractions were sharp but short-lived, with a solid V-shaped economic recovery in 1999 partly due to favorable global economic conditions, although post-crisis average growth rates were lower than in the pre-crisis period. The strength and pace of recovery varied significantly across countries; the Republic of Korea saw the fastest and strongest growth with only a temporary loss of output due to the crisis and returned quickly to the pre-crisis output trend, while Indonesia, Malaysia, and Thailand suffered large declines with semi-permanent loss of output. The impact of the crisis on the Philippines is less obvious as the country had been stagnant since the mid-1980s. Japan's economic recovery was slow and prolonged, resulting in the lost two decades.

The financial crises prompted the governments to implement aggressive policies to tackle the problem. Indonesia, the Republic of Korea, and Thailand invited the International Monetary Fund (IMF) to intervene and received liquidity support as well as policy advice on bank and corporate restructuring and on macroeconomic policy adjustments and structural reforms. Malaysia did not invite the IMF, but

received quick-disbursing adjustment loans and policy advice from the World Bank, particularly on bank and corporate restructuring.

15.3.2 Bank Restructuring

Bank restructuring was one of the most important policy foci for crisis management and response in Asian crisis-affected economies. It was only at later stages that corporate restructuring became prominent in the policy agenda. It was then learned that strategies for bank and corporate restructuring needed to be closely linked. Bank restructuring had to be done in tandem with corporate restructuring, particularly when the scale of corporate insolvency was huge and the size of NPLs large. One reason was that owners of failed or weak banks had no incentive to restructure their borrowers' debt (or their NPLs) because, if they had realized losses, the resulting write-down of capital would have brought on government intervention and they would have lost control of their banks. Another was that if solvent but illiquid corporations, along with assets of insolvent corporations, had not been restructured to put them back into operation, distress in the banking sector would have continued and the costs of debt restructuring would have risen as assets lost value and recovery rates fell.

Bank restructuring had several stages (Table 15.1): (1) stabilization of the banking system by restoring the confidence of depositors and creditors through the establishment of a deposit insurance system and the provision of liquidity support to troubled banks; (2) stoppage of the bleeding by way of intervening in clearly nonviable and insolvent banks, through liquidation (closures), mergers with healthier banks, or temporary nationalization of nonviable banks, which often required a clear legal and operational groundwork; (3) recapitalization and rehabilitation of weak but viable financial institutions, which required recognition of losses on NPLs, costs to existing owners to avoid a future moral hazard such as changes in ownership and management, and renewed incentives to restructure NPLs of viable borrowers; (4) effective prudential regulation and supervision, which enforced capital adequacy, loan classification, provisioning rules, and improvements in accounting and disclosure rules to bring them into line with international standards; and (5) strengthening of bank credit cultures and management by introducing more competition and risk management practices.

An important principle of bank restructuring was that the longer it took, the larger the eventual economic costs. Weak banks would have continued to accumulate assets that were likely to go bad, or bank owners would have lent to connected enterprises in the optimistic expectation that the loans would be repaid sometime in the future. The restoration of banking system health helped resume credit flows and economic activity in crisis-affected countries, although economic recovery took much longer in Japan than in emerging Asian economies.

Table 15.1 Agendas for bank and corporate restructuring

(A) Bank restructuring	(B) Corporate restructuring
1. Establish institutional framework • Deposit insurance • Liquidity support	1. Create enabling environment • Removing obstacles for mergers (legal) • Ease of debt equity swaps (legal) • Security interests (legal) • Tax incentives • Foreign ownership liberalization • Labor market flexibility
2. Resolve nonviable banks • Liquidate • Nationalize or absorb into other banks	
3. Recapitalize viable banks • Capital support programs from government • Foreign bank or strategic buyers • Stop-loss, put-back for strategic buyers • Foreign or domestic equity capital markets	2. Establish out-of-court mechanisms • Basic voluntary framework in place • Adequate incentives to participate
4. Resolve or restructure NPLs • Recognize full extent of NPLs • System-wide carve-out of NPLs • Restructuring of viable NPLs • Tax and other incentives for NPL restructuring • Foreclosure of nonviable NPLs • Sale of NPLs in the secondary market	3. Strengthen bankruptcy and foreclosure systems • Quality of bankruptcy law • Enforcement and judicial capacity in bankruptcy system • Foreclosure and insolvency procedures
5. Revamp regulatory frameworks for banking sector • Stronger prudential norms • Effective bank supervision and examination • Enforcement of bank regulation	4. Improve corporate governance • Effectiveness of ownership oversight and boards of directors • Shareholder rights and protection • International accounting, auditing and disclosure standards
6. Strengthen bank credit cultures and management • Bank consolidation • Foreign bank buy-ins • CAMELS rating for banks • Proper NPL definition, interest accrual, provisioning norms • Credit risk rating, scoring and monitoring systems	

CAMELS capital adequacy, asset quality, management quality, earnings, liquidity, sensitivity to market risk; *NPL* nonperforming loan
Source: Kawai (2000)

15.3.3 Corporate Restructuring

The phrase "corporate restructuring" is used to refer to both corporate debt and operational restructuring. Corporate debt restructuring may include debt rescheduling (an agreed-on rollover of loan principal and interest payments), debt-for-equity swaps, foreclosure, and forgiveness of principal and/or interest. Corporate operational restructuring may include asset sales to reduce debt levels, reductions in employment and production capacity, changes in the line of business, and closure of production facilities.

The governments of Asian crisis-affected countries implemented a broad, complex agenda for corporate restructuring (Table 15.1B). This included several steps: (1) creating the enabling environment for corporate restructuring by way of eliminating legal, tax, and regulatory obstacles (such as tax policies that impeded corporate reorganizations, mergers, debt-for-equity swaps, and debt forgiveness; restrictions on the participation of foreigners as holders of domestic equity and investors in domestic banks; and labor laws and other existing laws and regulations that hindered debt restructuring); (2) establishing a policy framework to facilitate out-of-court settlements, which were considered more efficient than court resolutions, and the facilitation of an orderly voluntary restructuring of debts—referred to as the "London approach" of the International Federation of Insolvency Professionals (INSOL)—there was a strong consensus that corporations had a better chance of survival under the London approach or provisions similar to Chap. 11 of the US bankruptcy code. In much of Europe, debt restructuring is negotiated out of court to avoid formal insolvency proceedings, which are often seen as unpredictable and lengthy, without any formal binding rules of engagement. The court-based procedure, including Chap. 11, has the advantage of being transparent in comparison to out-of-court settlements; (3) strengthening or introducing effective bankruptcy and foreclosure procedures to create appropriate incentives and "threats" for creditors and debtors to reach out-of-court settlements; and (4) improving corporate governance by increasing the extent of disclosure, curbing the power of large inside shareholders, putting in place a sizable number of outside shareholders, and making the financial system competitive and efficient.

Bankruptcy procedures had to be strengthened as part of debt resolution strategies to ensure that nonviable firms would not continue to absorb credit and that a creditor bank could recover the maximum value of the claims submitted to the insolvent debtor corporation. Although informal out-of-court settlements were considered more efficient than court settlements, an effective bankruptcy system was considered necessary and enforcement of bankruptcy procedures had to become a credible threat as an alternative to out-of-court settlements (see Kawai 2000; Kawai et al. 2000).

Better corporate governance was expected to attract investment, improve management efficiency, and stimulate longer-term growth. The introduction of a sizable number of outside (often foreign) shareholders was complemented by reforms in board composition, structure and responsibility, as well as by improvements in minority shareholder rights in order to ensure effective board oversight of management. Legislative changes were needed and made to pursue these reforms.

15.3.4 Coordinated Approach to Bank and Corporate Resolution

To resolve the troubled assets of banks, it was necessary to work on the underlying problem of bad loans to the corporate sector. For this purpose, the governments of crisis-affected economies forged strong links between bank and corporate restructuring. The governments and central banks had to find a credible mechanism that would encourage banks to recognize losses and restructure failing corporations, as an individual bank might not have sufficient incentive to adopt drastic measures such as write-downs and debt–equity swaps, thus leaving "zombie" borrowers intact. Caballero et al. (2008) discuss the problem of "zombie" corporations. They propose a model that highlights the implications of the zombie problem for restructuring. The congestion created by "zombie" corporations reduces the profits of healthy firms, discouraging their entry and investment. In the presence of zombie firms, economic recovery is delayed significantly. Without well-functioning bankruptcy courts, registries of security interests and foreclosure procedures, creditor banks would have no incentive to make concessions to debtors. Nor would corporate debtors have incentives to negotiate with creditor banks without new funds coming in. Without credible court enforcement of contract law or trusted out-of-court mechanisms, corporate debtors might resort to strategic defaulting. In a sense this was a "prisoner's dilemma" because of the lack of mechanisms to support creditor–debtor coordination.

Recognizing this, the authorities of crisis-affected countries introduced a host of measures to help coordinate policy and to carry out institutional and legal actions for bank and corporate restructuring. Table 15.2 summarizes the institutional designs created by these governments and central banks to coordinate bank and corporate restructuring, so that a socially optimum outcome would be reached. The authorities identified major support institutions for restructuring and created or nominated agencies for bank recapitalization, asset purchases and management, and corporate debt restructuring. A bank in trouble because of nonperforming loans on its books could sell them to an asset management company. If the bank remained in financial trouble and was unable to raise sufficient capital from shareholders and the market, it could seek assistance from a recapitalization agency for public recapitalization. Meanwhile, a debt restructuring agency acted as an informal mediator, often adopting the London rules approach, and facilitated voluntary negotiations between borrowers and their creditors to achieve voluntary restructuring schemes. These agencies attempted to link their efforts as much as possible.

These institutional designs were backed up by revamped legal frameworks for corporate insolvency, establishment of bankruptcy courts, and the creation of procedures for out-of-court workouts.

For example, the Indonesian authorities' strategy for corporate restructuring included several elements: (1) establishment of the Indonesian Bank Restructuring Agency (IBRA) as a major support agency for bank and corporate restructuring and

Table 15.2 Institutional frameworks for bank and corporate restructuring in Asia

Country	Major support institution	Agency for bank recapitalization	Asset management company	Agency for voluntary corporate restructuring
Indonesia	Indonesian Bank Restructuring Agency (IBRA)	Direct from Bank Indonesia (BI) or via IBRA	IBRA	Jakarta Initiative Task Force (JITF)
Malaysia	Bank Negara Malaysia (BNM)	Danamodal	Danaharta	Corporate Debt Restructuring Committee (CDRC)
Thailand	Bank of Thailand (BOT)	Financial Restructuring Advisory Committee (funded by the Financial Institutions Development Fund)	FRA to take assets of closed finance companies; unsold assets moved to AMC and good assets to RAB. TAMC for commercial banks	Corporate Debt Restructuring Advisory Committee (CDRAC)
Republic of Korea	Financial Supervisory Service (FSS)	Korea Deposit Insurance Corporation (KDIC)	Korea Asset Management Corporation (KAMCO)	Corporate Restructuring Coordination Committee (CRCC)
Japan	Financial Services Agency (FSA)	Deposit Insurance Corporation (DICJ)	RCC and IRC	None. Oversight by FSA

FRA Financial Sector Restructuring Authority, *AMC* Asset Management Corporation, *RAB* Radanasin Bank, *TAMC* Thai Asset Management Corporation, *RCC* Resolution and Collection Corporation, *IRC* Industrial Revitalization Corporation
Source: Kawai (2000, 2005)

as an asset management company; (2) introduction of the Jakarta Initiative and the Jakarta Initiative Task Force (JITF) to facilitate voluntary negotiations between debtors and creditors for corporate restructuring and to provide a regulatory "one-stop shop" for administrative procedures pertaining to debt resolution; (3) introduction of a new and improved bankruptcy system and a special commercial court to provide a credible threat (out-of-court settlements); and (4) establishment of the Indonesian Debt Restructuring Agency under the Frankfurt Agreement to provide foreign exchange cover for Indonesian corporations with foreign currency-denominated debt once they reached debt restructuring agreements.

The government took several steps to accelerate corporate debt restructuring and asset recovery. First, an interagency committee, comprising representatives from Bank Indonesia, IBRA, and the Ministry of Finance, was formed to implement and

monitor the restructuring and asset recovery process. Second, the names of debtors were made public to induce corporate debtors to begin settlement negotiations. Many of these corporate debtors signed letters of commitment indicating a willingness to negotiate a settlement as the government said it would take legal actions against uncooperative corporations that failed to reach a restructuring agreement with IBRA. Third, commercial courts were established to offer credible bankruptcy procedures to induce corporate debtors to negotiate voluntarily. Disclosure rules were strengthened to discourage strategic defaulting of solvent debtors. A new Secured Transactions Law encouraged creditors to provide new working capital.

Malaysia established a solid institutional framework for tackling bank and corporate restructuring in unison. The authorities created three agencies—Danaharta, Danamodal, and the Corporate Debt Restructuring Committee (CDRC)—to carry out a comprehensive restructuring of the banking and corporate sectors. Danaharta was an asset management company with functions similar to those of the US Resolution Trust Corporation; Danamodal Nasional Berhad was established to recapitalize the banking sector, especially to assist banks whose capital base had been eroded by losses; and CDRC was established to reduce stress on the banking system and to repair the finances and operations of corporate borrowers. A bank in trouble could transfer its NPLs to Danaharta and have it sell them. If the bank was unable to raise sufficient capital from shareholders, it could seek assistance from Danamodal for recapitalization, diluting the original shareholders. In exchange, Danamodal could facilitate consolidation of the banking sector by selling its stake to a stronger bank and thereby fostering bank mergers. Meanwhile, the CDRC acted as an informal mediator, facilitating dialogue between borrowers and their creditors to achieve voluntary restructuring schemes. When the CDRC could achieve this, NPLs were resolved voluntarily. When it could not, Danaharta would take over the bad loans, disposing of them over the long term.

The Thai government established the Financial Sector Restructuring Agency to take assets of closed finance companies and the Asset Management Corporation to absorb unsold assets. It also established the Corporate Debt Restructuring Advisory Committee (CDRAC) to coordinate debt restructuring and developed the Framework for Corporate Debt Restructuring, an adaptation of the London rules approach. This permitted debtors to negotiate with multiple creditors to reach voluntary agreements. Relative to the magnitude of the problem, corporate debt restructuring through this framework slowly began to yield results. In contrast to the situation in other crisis-affected countries, small and medium-sized enterprises (SMEs) in Thailand accounted for more than two-thirds of aggregate corporate debt; therefore, restructuring required far more effort. The Thai judicial system slowly began to demonstrate its determination to enforce the revised bankruptcy and foreclosure procedures to prompt strategic defaulters to resume paying their debts.

The Philippines did not experience systemic crises in the banking or corporate sector and, as a result, did not face the urgent need to develop a systemic approach to banking and corporate sector crisis resolution. However, realizing the economy's structural weaknesses, the government acted to strengthen the banking sector and

the supervisory and regulatory framework. Debt restructuring was carried out on an informal or formal basis according to procedures dictated by the existing legal framework for insolvency. When informal debt resolution proved impossible, a distressed corporation could petition the Securities and Exchange Commission (SEC) for protection from its creditors. The SEC then had the power to: (1) impose stays of actions by creditors against corporate debtors, (2) permit debtors to suspend payments to their creditors, (3) decide whether a debtor should be liquidated or be permitted to attempt rehabilitation, and (4) liquidate debtors and appoint receivers, members of management committees, and liquidators.

The Korean government created an independent agency, the Financial Supervisory Commission (FSC), in 1997 to supervise and restructure all banks and nonbank financial institutions. This agency was later expanded into the Financial Supervisory Service (FSS) in 1999 by merging four financial supervisory agencies (banks, nonbanks, securities, and insurance). The government set up a special fund within the Korea Asset Management Corporation (KAMCO) in 1997 to which banks were allowed to sell their NPLs. Later in the year, KAMCO was moved from the Ministry of Finance and Economy to the control and supervision of FSC as a public agency, or a bad bank, to manage nonperforming assets. As 64 *chaebols* (conglomerates) accounted for the bulk of corporate debt in the Republic of Korea, the government had to take decisive measures to: (1) reduce corporate debt-to-equity ratios; (2) remove cross-guarantees between subsidiaries within a *chaebol*; and (3) enforce business swaps ("Big Deals") among largest *chaebols*. The top five *chaebols* implemented "Big Deals" involving key business areas—such as automobiles and semi-conductors—with the objectives of reducing overcapacity and high leverage and focusing on core competency. By the end of 2000, business swaps in the four industries of oil refinery, semiconductors, vessel engines, and power plant equipment were completed, followed by aerospace, petrochemical, and rolling stock. The top *chaebols*' restructuring through "Big Deals" and mergers of firms that competed in the same industries began to realize economies of scale and enhance the global competitiveness of Korean firms. These same five *chaebols* agreed to Capital Structure Improvement Plans (CSIPs) to undertake (1) and (2) above. Although creditor banks accepted the CSIPs of the top five *chaebols*, they did not play a role in the restructuring process, at least until a later stage. The "6–64" *chaebols* also agreed on CSIPs with their creditor banks and pursued corporate restructuring. Other companies applied to the formal workout program within the Corporate Restructuring Coordination Committee framework. Corporations classified as financially weak but viable began bank-led rehabilitation, referred to as "workout programs." Workout programs were implemented through debt-to-equity swaps among companies that were still viable and competitive but suffered from a temporary liquidity shortage.

The Japanese government introduced a framework for voluntary, multi-creditor out-of-court negotiations for corporate restructuring—using the London rules of the INSOL International. This was based on the recognition that, while legal insolvency procedures would secure transparency, they lacked the speed and flexibility needed for efficient corporate debt restructuring. However, the major focus of this

voluntary framework was on setting guidelines for debt forgiveness, rather than on a comprehensive debt restructuring negotiation process.

The government established two asset management companies, the Resolution and Collection Corporation (RCC) and the Industrial Revitalization Corporation of Japan (IRCJ). These were designed to accelerate corporate restructuring and the disposal of NPLs through purchases of such loans from banks, while each targeting different types of loans and corporations. The RCC was essentially a collection company that purchased and sold collateralized NPLs from firms classified as "in danger of bankruptcy" or "bankrupt," focusing on smaller, nonviable firms. Its function was subsequently strengthened by allowing it greater flexibility to decide the purchase price—i.e., at fair value—and to buy NPLs from healthy institutions.

The IRCJ, in contrast, focused on higher-quality NPLs—classified as "need special attention"—for larger firms. It purchased loans for 2 years and disposed of them within 3 years of purchase. The objective was to promote restructuring of relatively large, troubled but viable firms by purchasing their loans from secondary banks, leaving the main bank and the IRCJ as the only major creditors.

15.3.5 Broader Reforms in Substantive and Procedural Law

In crisis-affected countries, the revamping of legal frameworks for bank and corporate restructuring may have raised awareness of the need for legal reforms and of efforts to increase the effectiveness and efficiency of justice in subsequent years. Even legislators or judges whose institutional environments may not have predestined them to become legal reformers were found leading legal reform initiatives for economic development. Indonesian legislators took advantage of the end of the Suharto regime to pass new laws governing finance and competition. Malaysia's and Thailand's judiciaries initiated efforts to reduce court backlogs and the duration of civil procedures. In Japan, the Koizumi government took the unprecedented step in 2002 to force banks to write down the remaining NPLs on their balance sheets.

Interestingly, all these countries adopted similar approaches to bank and corporate restructuring and legal reforms, despite the considerable variation in the six countries' legal systems and stages of economic and legal development. The countries underwent similar experiences of crisis response, resolution and legal reforms. This is partly explained by the fact that the same international financial institutions (IFIs)—the IMF, the World Bank, and the Asian Development Bank—intervened in Indonesia, the Republic of Korea, and Thailand, and assisted them in bank and corporate restructuring by recommending international best practices for bank and corporate restructuring and legal and judiciary reforms. Malaysia was not subjected to IMF programs but did receive adjustment loans and policy advice from the World Bank, which led to an approach similar to those employed in other countries. Japan was the only country that was not subject to intervention or assisted by these IFIs, but nonetheless it quickly adopted similar best practices for legal

reforms. Thus, there was a remarkable commonality in the actions taken to create the enabling legal environment for both immediate crisis resolution through bank and corporate restructuring and more sustained economic growth and development through fundamental legal reforms.

15.4 Country Experiences of Institutional and Legal Reforms

15.4.1 Indonesia's Legal Reforms

When the financial crisis erupted, Indonesia's Bankruptcy Law, which had been introduced in 1905 during the Dutch colonial rule, was dysfunctional. Facing the need to support resolution of systemic corporate insolvencies, the Bankruptcy Law was amended in 1998 to promote prompt and fair resolution of commercial disputes and provide a framework to encourage debtors and creditors to seek out-of-court settlements. To expedite dispute resolution, the authorities also established the Commercial Court (Pengadilan Niaga) in 1998. Initially, the Commercial Court was intended to handle only bankruptcy and insolvency applications, but its jurisdiction was extended to other commercial matters. Appeals from the Commercial Court proceed directly to the Supreme Court. Due to inadequacies in the amendments and fundamental problems in the judiciary system, a completely new Indonesian Bankruptcy Law (Law Number 37 of 2004 on Bankruptcy and Suspension of Payment) was introduced in 2004 (Table 15.3).

Although there had been a movement in favor of "healthy business competition" in the early 1990s among Indonesian scholars, political parties and some government institutions, the financial crisis became the proximate cause of such legislation in 1999. Following a letter of Intent to the IMF, the Indonesian government submitted a draft antimonopoly law to the parliament, which enacted it in March 1999. The basic structural purpose of the law was to deconstruct the patron–client social structure that had been part of Indonesian business culture through the pre-colonial, colonial and post-independence periods (Maarif 2001). This was a big step toward improving the quality of Indonesia's legal system.

After the end of the authoritarian Suharto era in 1998, the first task for the reform of the judiciary was to bring it into line with the process of democratization. In a country characterized by regional, ethnic and religious diversity, democratization also meant decentralization, or what Hill (2013) calls the transformation of Indonesia into "a federal state" in all but name. These two imperatives dictated two priorities for the judiciary: ending the control of the courts by the military (Ricklefs 2001) and establishing new courts in newly created provinces and districts. The first priority meant rapidly recruiting new judges untainted by the legacy of corruption of the old regime, and the second allocating fiscal resources for a massive expansion of judicial infrastructures. Neither was easy or fast. Each of the 260 new districts

Table 15.3 Legal and institutional changes to facilitate corporate restructuring: Indonesia

Year changed	Laws, procedures, and institutions	Contents
January 1998	Establishment of the Indonesia Bank Restructuring Agency (IBRA)	Oversight of financial sector rehabilitation
February 1998	Amendment to Corporate Annual Financial Information (No. 24, 1998)	Obligations for companies to submit financial report
July 1998	Establishment of Indonesia Debt Restructuring Agency (INDRA)	Enabling debtors to eliminate exchange rate risk on future debt service payments
September 1998	Establishment of Jakarta Initiative Task Force (JITF)	Facilitating out-of-court workout procedures and negotiations to restructure corporate debt (until December 2003)
September 1998	Amendment to Bankruptcy Law (No. 4, 1998)	Promotion of prompt and fair resolution of commercial disputes; provision of a framework to encourage debtors and creditors to seek out-of-court settlements
September 1998	Establishment of Commercial Courts	Processing petitions for declaration of bankruptcy and moratorium of debt repayment
March 1999	Prohibition of Monopolistic Practices and Unfair Business Competition (No. 5, 1999)	Provision of a comprehensive legal framework for business competition policies
1999	Establishment of the National Committee on Corporate Governance (NCCG)	Publication of the Code for Good Corporate Governance
2003	State-Owned Enterprises Law (No. 19, 2003)	Comprehensive legislation governing state-owned enterprises
2004	Law on Bankruptcy and Suspension of Payment (No. 37, 2004)	Provision of clarity to details such as time frames, the rights of the various parties to enhance the efficiency of bankruptcy processes

Source: Lek&Co Lawyers, Indonesian Bankruptcy Law Blog, various posts, www.indonesiabankruptcylaw.com, Maarif (2001), Sato (2005), Booth (2009)

required a new (first instance) district court and each of the eight new provinces a new (appellate) high court. A new Constitutional Court was created, in addition to the existing Supreme Court. The recruitment of judges and investments in court infrastructure were enormous and posed significant challenges to the implementation of laws.

Not surprisingly, decentralization was a source of uncertainty for post-crisis recovery in Indonesia. Given the magnitude of the fundamental reforms to be undertaken, Indonesia's legal transformation has faced conflicting interests, involved high costs, and required a long time horizon.

15.4.2 Malaysia's Approach

Malaysia's bankruptcy law is governed by the Bankruptcy Act of 1967, derived from the English Bankruptcy Act of 1883, which governed trade and commerce in England. Although English common law and legislation was a colonial transplant to Malaysia, the Bankruptcy Act had been adapted in accordance with local needs and had thus evolved into a distinct insolvency law. The Bankruptcy Act was amended a few times, including in 1988 and 2000 (which came into force in 2003). The objective of the most recent amendment was to keep abreast with international changes in the law relating to insolvency. The amended act adopted a unitary approach to the administration of insolvency, under the Insolvency Department headed by the Director General of Insolvency (Table 15.4).

The corporate restructuring framework—comprising Danaharta, Danamodal, and the Corporate Debt Restructuring Committee—worked reasonably well, with a few amendments to the Bankruptcy Act, although the judicial side remained a challenge.

A World Bank report (World Bank 2011) requested by the Malaysian judiciary on progress of reforms initiated in 2008 revealed that, since the 1980s, the judiciary as a whole had gone through a period of declining performance and public confidence. Malaysia's ratio of judges per 100,000 inhabitants ranged between 1.5 and 2.4 (depending on whether members of the Judicial and Legal Service assigned to the courts were included). This was very low compared with ratios in other countries at a comparable level of development within and outside Asia. Hence, cases commonly took unpredictable periods of time to resolve, depending on the disposition of the judge and the actions exercised by the lawyers. Each judge operated in relative isolation, leading to considerable variations in how cases were processed, and an often-disorganized management of internal administration.

A first significant step to reduce case backlog and procedural delay was the introduction of pre-trial case management into the Rules of the High Court in 2000. This move was intended to take control of the progress of a case out of the hands of the attorneys and to give it to the court, thereby reducing a good deal of unnecessary delay. To allow the High Court divisions in charge of civil and commercial law to reduce their backlog of cases, New Commercial Courts and New Civil Courts were created as part of the 2008 reform program. These were to receive only new cases filed after their establishment. In April 2010, the judiciary introduced the possibility of court-annexed mediation for commercial, family, and other civil cases. By September 2010, the number of pending cases had been reduced by two-thirds, from 3,759 to 1,228. But, of course, reducing the backlog does not mean shorter disposition times and higher clearance rates for newly filed cases. The World Bank recommended that better trained judges, especially in first-instance courts, should take the pace of procedures out of the hands of attorneys and enable cases to be managed more actively and efficiently than in the past (World Bank 2011).

Judging by the time that had passed since Malaysia's independence without major legal reforms, a catalytic effect such as the financial crisis was clearly needed to open the prospect of a much more ambitious judicial reform in line with the

Table 15.4 Legal and institutional changes to facilitate corporate restructuring: Malaysia

Year changed	Laws, procedures and institutions	Contents
June 1998	Creation of Danaharta (national asset management company)	Removal of nonperforming loans from the banking system to assist corporate restructuring (until December 2005)
July 1998	Creation of Danamodal	Recapitalization of viable banks
July 1998	Creation of the Corporate Debt Restructuring Committee	Mediation of voluntary out-of-court debt restructuring
March 2000	Code on Corporate Governance	Regulations governing the board of directors, supply of information, accountability and audit, shareholders' rights and protection, evaluation, disclosure and transparency
March 2001	Financial Sector Masterplan	Reform recommendations on banking sector, insurance sector, Islamic banking and *takaful* (Islamic insurance), development of financial institutions and offshore finance market
October 2003	Amendment to the Bankruptcy Act of 1967 in force	Adoption of a unitary approach to the administration of insolvency
July 2005	Malaysia Deposit Insurance Corporation Act of 2005	Facilitating execution of bank resolution processes
September 2008	Establishment of New Commercial Courts	Improving the efficiency of enforcing contracts

Source: Law Business Research (2013), Malaysia entry (pp. 308–319), Booth (2009), Cooper (2009)

World Bank's suggestions. Malaysia's judiciary has recognized the problem; it will have to allocate bigger budgets for legal education and training of future generations of first instance judges.

15.4.3 Thailand's Legal Reforms

The Thai Bankruptcy Act of 1940 was patterned after the English Bankruptcy Act of 1914. There was no rehabilitation or reorganization mechanism for business entities. The main purpose of the crisis-induced amendments in 1998 and 1999 was to add such provisions. The result was a hybrid of the US pattern of reorganization under Chap. 11 and the English pattern of rehabilitation modeled on English insolvency law (Wisitsora-At 2005). Whereas previously bankruptcy cases fell into civil court competence, the urgency of the financial crisis required them to be dealt with quickly without being held up by the backlog of other civil law cases, and the Bankruptcy Court was established in 1999. The sustained numbers of new reorganization cases filed with the court as well as of bankruptcy filings since 1999 suggests that the reform was accepted and effective (Table 15.5).

The caseload in Thai civil courts has dramatically increased since the early 1990s. This has resulted in case backlogs and delays in court proceedings.

Table 15.5 Legal and institutional changes to facilitate corporate restructuring: Thailand

Year changed	Laws, procedures, and institutions	Contents
October 1997	Establishment of Financial Sector Restructuring Authority (FRA)	Processing early disposal of NPLs held by finance companies to reconstruct the financial system
October 1997	Establishment of Asset Management Corporation (AMC)	Facilitating early disposal of NPLs held by finance companies
April 1998	Amendment to the Bankruptcy Act of 1940 (No. 4, 1998)	Adding a new chapter to the act to enable reorganization of potentially viable corporations
June 1998	Establishment of the Corporate Debt Restructuring Advisory Committee (CDRAC)	Facilitating informal workouts and voluntary processed of corporate restructuring (based on the London Approach)
September 1999	Establishment of Central Information Services Co., Ltd.[a]	Gathering of loan data from financial institution members
March 1999	Further amendment to the Bankruptcy Act (No. 5, 1999)	Strengthening the principal provisions of the 1998 amendment
June 1999	Establishment of Bankruptcy Courts (Central Bankruptcy Court, Regional Bankruptcy Court, and Bankruptcy Division, Supreme Court)	Jurisdiction over all bankruptcy cases and all civil matters pertaining to bankruptcy cases
June 2001	Establishment of Thai Asset Management Corporation (TAMC)	Resolving NPL problems of state-owned and private financial institutions (until 2013)
November 2002	Credit Information Business Act	Regulation of the credit information business, including the operators, their rights and obligations, and privacy protections of credit information
2002	Establishment of National Corporate Governance Committee (NCGC)	Setting policies, measures, and schemes to upgrade the level of corporate governance among institutions, associations, corporations and government agencies in the capital market
2006	Regulations for bankruptcy cases	Major new regulations and amendments to the Bankruptcy Act to deal with bankruptcy and reorganization procedural matters

Source: Law Business Research, Thailand entry, pp. 486–492 (2013), Booth (2009), Cooper (2009)

[a]The name changed to the National Credit Bureau, Co., Ltd. from May 2005

To promote access to justice and to address increasing delays in court proceedings, the Thai judiciary recognized the need to implement measures to increase procedural efficiency. Chief among these were the introduction of case management—such as pre-trial conferences and a fast track/regular track division of cases—and court-annexed mediation. In 2000, the Civil Court started providing an option for parties to refer cases to mediation before the first hearing day. This has helped

parties settle their cases before the onset of costly and time-consuming litigation (Phitayaporn 2003).

15.4.4 The Philippines' Legal and Judicial Reforms

In the Philippines, the Insolvency Act of 1909 was the principal legislation on corporate insolvencies, addressing suspension of payment, voluntary insolvency, and involuntary insolvency. Under this act, the judicial courts had jurisdiction over these proceedings. Presidential Decree (902-A) of 1976 expressly established the concept of rehabilitation (not insolvency), which applied only to corporations, and allowed the corporation to recover and to continue as a going concern. However, the decree lacked rules that would provide for an effective corporate recovery system. The Philippines Securities and Exchange Commission (SEC) adopted the first major set of rules and procedures on corporate recovery in 1999. In 2001, the Congress began to work on reviewing and updating the Insolvency Act, including the introduction of a fast track mechanism for informal workouts. In 2010, the Financial Rehabilitation and Insolvency Act was finally introduced and enacted to consolidate and codify scattered provisions on rehabilitation and liquidation into one comprehensive law (Table 15.6).

Sicat (2007) notes that the growth of the Philippine economy in the early years of independence, although significant (averaging 5.5 % per year), was not at the same level as that of other "East Asian Miracle" countries, mainly because of restrictive policies towards foreign direct investment. These were inspired by the country's development strategy enshrined first in the Constitution of 1935 and retained ever since through successive constitutional changes. He also describes structural weaknesses in the legal system of the Philippines, which are similar to those in Malaysia before the 2008 reforms, such as the small number of professional judges, case backlogs, and delays. Given the weaknesses of the formal legal system, the enactment of the law on Alternative Dispute Resolution (ADR) in 2004 is significant, with an impact on the number of court cases dealing with commercial disputes (Sicat 2007).

Delays in court proceedings, expensive litigation fees, and the rigid and inflexible system of courts have encouraged parties to disputes to resort to several forms of other dispute resolution procedures. Considered to be an alternative to litigation, ADR procedures include arbitration, mediation, conciliation, mini-trials and early neutral evaluation. ADR methods are encouraged by the Philippine Supreme Court and were held to be valid and constitutional even before laws were enacted to regulate these procedures. It may be noted however, that the Supreme Court has in recent years begun pursuing various judicial reform projects to decongest courts and jails, improve case management, and increase access to justice. These projects include: (1) the Efficient Use of Paper Rule which promotes a paper-less system in the judiciary; (2) Enhanced Justice on Wheels which uses mobile courts to provide legal aid to detainees as well as legal information in the local community; (3) Small

Table 15.6 Legal and institutional changes to facilitate corporate restructuring: the Philippines

Year changed	Laws, procedures and institutions	Contents
November 1999	Rules and Procedures on Corporate Recovery	First major set of rules and procedures on corporate recovery adopted by Philippine SEC
April 2000	Amendment to the General Banking Law (R.A. 8791)	Promotion and maintenance of a stable and efficient banking and financial system; Foreign banks allowed to acquire up to 100 % of the voting stock (effective within 7 years)
July 2000	Securities Regulation Code (R.A. 8799)	SEC's jurisdiction over the speedy resolution of disputes and complaints
2001	Review and beginning of the overhaul of the Insolvency Act of 1909 (Act No. 1956, 1909)	Work begun by Congress to update insolvency laws that deals with suspension of payments, voluntary insolvency, and involuntary insolvency
April 2002	Code of Corporate Governance	Regulations on the board of directors, supply of financial information, accountability and audit, shareholders' rights and protection, evaluation, disclosure and transparency
April 2004	Introduction of Alternative Dispute Resolution (R.A. 9285)	Encouraging and regulating arbitration, mediation, conciliation, mini-trial and early neutral evaluation
2007	Proposal for fast track mechanism for informal work-outs introduced	Special chapter in draft Corporate Recovery and Insolvency Act introduces idea of fast-track approach
September 2008	Credit Information System Act (R.A. 9510)	Establishment of a centralized credit information system
December 2008	Detailed rules of procedure governing rehabilitation issues	Supreme Court uses its rule-making power to create Rehabilitation Rules in 2000 & 2008
January 2009	Supreme Court Rules of Procedure on Corporate Rehabilitation (No. 00-8-10-SC)	Whole body of corporate rehabilitation developed, including procedural rules and key provisions that bordered on substantive laws
February 2010	Financial Rehabilitation and Insolvency Act	Enacted to consolidate and codify scattered provisions on rehabilitation and liquidation into one comprehensive law, through the establishment of a systematic framework for insolvency proceedings and provision of equitable treatment to all parties

Source: Booth (2009), Cooper (2009) and Lim (2013)

Claims Project which provides for an inexpensive, informal, and simple procedure for small money claims; and (4) other projects to enhance the information technology capabilities of courts. All of these initiatives scope all cases brought before it including corporate recovery cases.

Table 15.7 Legal and institutional changes to facilitate corporate restructuring: Republic of Korea

Year changed	Laws, procedures and institutions	Contents
1996	Revision of Supreme Court Rule on Corporate Reorganization Procedure of 1992 revision	Courts now able to exclude incumbent management from reorganization process and to disregard controlling shareholders responsible for mismanagement
June 1997	Creation of Financial Supervisory Commission (FSC)	Agency to supervise and restructure all banks and nonbank financial institutions
August 1997	Special fund set up in Korea Asset Management Corporation (KAMCO)	Banks allowed to sell their NPLs to KAMCO
November 1997	KAMCO reorganized under the supervision of FSC	KAMCO disposes of NPLs and assists with corporate restructuring
June 1998	Financial Institutions Arrangement for Facilitating Corporate Restructuring; creation of the Corporate Restructuring Coordination Committee (CRCC)	Introduction of voluntary procedures for corporate debt restructuring. FSC in charge of implementing major and voluntary work-outs (London approach)
December 1998	Revision of Commercial Law	Procedures for corporate splits introduced
January 1999	Establishment of Financial Supervisory Service (FSS)	An integrated financial supervisory authority over banks, nonbanks, securities, insurance
April 1999	Revision of KAMCO Law	Provision of bad bank function to KAMCO
October 2000	Financial Holding Company Law	Establishment of financial holding companies allowed
October 2000	Corporate Restructuring Investment Companies Act	Establishment of a corporate restructuring vehicle
February 2001	Rules on Regular Assessment of Corporate Credit Risk	Continuous corporate restructuring based on regular assessment results
March 2001	Revision of Corporate Reorganization Act	Shorten corporate restructuring procedures by introducing prepackaged bankruptcy
March 2001	Revision of Securities Investment Company Act	Establishment of mergers and acquisitions (M&A) fund
September 2001	Corporate Restructuring Promotion Act	Out-of-court informal workout program to help ailing firms and later financial institutions; reenacted in August 2007
December 2004	Revision of Indirect Investment Asset Management Act	Private equity fund for M&A purposes allowed
April 2006	Debtor Rehabilitation and Bankruptcy Act (DRBA)	New insolvency law governing all bankruptcy and reorganization proceedings in Korea in integrated fashion

Source: Law Business Research (2013), Korea entry (pp. 278–284), Financial Supervisory Service

15.4.5 Republic of Korea's Legal Reforms

Major aspects of corporate restructuring in the Republic of Korea included exits or bankruptcy of non-viable companies, rehabilitation through workout programs for viable companies, and business swaps among *chaebols*. The principles of bankruptcy were adopted from the German legal system, which was introduced via Japan. The principles of rehabilitation were largely modeled on US federal law, such as Chap. 11 protections.

In June 1998 almost all Korean financial firms entered into the Financial Institutions Arrangement for Facilitating Corporate Restructuring (known as the Master Workout Arrangement), introducing an informal workout system into the Korean insolvency regime. The government subsequently enacted the Corporate Restructuring Promotion Act (effective from September 2001 until the end of 2005), which replaced the Master Workout Arrangement with the aim of facilitating and expediting informal workouts. This became the basic law governing out-of-court informal corporate rescue procedures (Table 15.7).

In response to difficulties in reaching agreement between creditors and a lack of professionals in the management of insolvent firms, the government used KAMCO to promote corporate restructuring of insolvent firms and to address financial institutions' NPLs. The government also introduced a corporate restructuring vehicle through the Corporate Restructuring Investment Companies Act in October 2000.

In April 2006 the government introduced the Debtor Rehabilitation and Bankruptcy Act, also known as the Unified Insolvency Law. The act consolidated the Corporate Reorganization Act, the Composition Act, the Bankruptcy Act, and the Act on Rehabilitation of Individual Debtors to establish systematic procedures for the rehabilitation and liquidation of insolvent firms and individuals. The act also established a rehabilitation procedure to modify and improve the previous reorganization procedure. As a result, the act provided for two corporate insolvency procedures: bankruptcy and rehabilitation.

15.4.6 Japan's Progress on Insolvency Reforms

Before recent reforms, the Japanese insolvency system consisted of two liquidation procedures—liquidation (*hasan*) and special liquidation (*tokubetsu seisan*)—and three reorganization procedures—corporate restructuring (*kaisha kosei*), civil rehabilitation (*minji saisei*) and corporate reorganization (*kaisha seiri*). Because these insolvency procedures were legislated separately long ago, the system was incoherent and outdated. To help accelerate corporate restructuring, more flexible procedures had to be introduced (Table 15.8). As a result, the Japanese legal system is no longer regarded as an impediment to corporate restructuring.

Table 15.8 Legal and institutional changes to facilitate corporate restructuring: Japan

Year changed	Laws, procedures and institutions	Contents
1997	Commercial Code	Procedures for corporate mergers rationalized
December 1997	Anti-Monopoly Law	Establishment of pure holding companies allowed
March 1998	Financial Holding Company Law	Establishment of financial holding companies allowed
July 1998	Financial Supervisory Agency created	To take over the functions of supervision and inspection of the financial system from MOF, with the policy planning function left with MOF
December 1998	Financial Reconstruction Commission (FRC) established	A parent body of the Financial Supervisory Agency, with oversight of the financial industry
1999	Commercial Code	Share swaps introduced; procedures related to parent and subsidiary companies rationalized
April 1999	Resolution and Collection Corporation (RCC)	A collection company to purchase and sell collateral-based NPLs—"in danger of bankruptcy" or blow
April 2000	Civil Rehabilitation Law (*Minji Saisei Ho*)	Facilitates filings and decisions for large number of firms
July 2000	Financial Services Agency (FSA) newly established	To merge the Financial Supervisory Agency and the policy planning function of MOF
2000	Commercial code	Procedures for corporate splits introduced
September 2001	Voluntary procedures for corporate debt restructuring based on the London rules (by INSOL)	Guidelines for debt forgiveness agreed
April 2003	Corporate Restructuring Law (*Kaisha Kosei Ho*)	Restructuring provisions eased and some flexibility allowed in the restructuring measures in line with those of the Civil Rehabilitation Law
April 2003	Industrial Revitalization Corporation of Japan (IRCJ)	Restructuring of large firms made easier through purchase of NPLs from all non-main bank creditors (until 2007)

Sources: Japan's Financial Services Agency; Japan's Ministry of Finance; OECD

Japan's debate on how to remove the burden of NPLs on the balance sheets of banks was protracted and the balance sheet problems of commercial banks were effectively addressed only in October 2002. The Financial Services Agency (FSA) enforced a fair value repricing of bank assets and rigorous write-downs of NPLs combined with recapitalization and restructuring of the banking sector. Only then did Japan's banks recover the ability to carry out financial intermediation and the Japanese economy to bounce back, although this bounce was not sufficient to reverse losses of the "lost decade" since the bursting of the bubble.

Japan has had a good record of procedural efficiency. However, in 1999, the Cabinet-level Justice System Reform Council was created for the achievement, among others, "of a legal profession as it should be." The ratio of lawyers practicing as *bengoshi* at court was only 19 per 100,000 inhabitants in 2004 (Lubbers 2010), compared with 388 in the US (2011), 265 in England and Wales (2006), and 168 in Germany (2006) (Schmiegelow 2013). Although the low density of professional lawyers could be seen as in keeping with Japan's low litigation rate, there has been a movement toward adopting American patterns both in financial crisis resolution and in the legal profession. As a result, 74 new law schools opened in 2004 and 2005. While more than 35,000 candidates took the nationwide law school admission test in 2003, their numbers dropped every year thereafter to about 10,000 in 2009 (Lubbers 2010). The unexpectedly high number of law schools and candidates was not matched by a corresponding rise in the capacity of the combined classes for trainees of judges, prosecutors and lawyers at the Legal Training and Research Institute of Japan. In addition, just like the American Bar Association, the Japan Federation of Bar Associations does not appear too eager to let competition between lawyers increase to the point of reducing their income (Lubbers 2010).

15.5 Quality of Legal Institutions

15.5.1 Indicators of the Quality of Legal Institutions

We next examine whether the legal and judicial reforms undertaken by each of the six crisis-affected countries have actually led to improvements in the quality of legal institutions. Measuring the quality of legal institutions is not an easy task. In this section, we examine three indicators published by the World Bank as part of its Worldwide Governance Indicators: (1) regulatory quality, (2) rule of law, and (3) control of corruption. These indicators measure the quality of legal institutions beyond those for bank and corporate restructuring needed to resolve financial crises. They cover much wider and more diverse areas, from regulatory quality (including agricultural, environmental, industrial, and consumer regulations), to the extremely broad concept of the rule of law (including constitutional law, human rights, criminal law, international law, administrative law, public order, military laws), and to specific laws on corruption control. But we assume they can serve as suggestive proxy indicators for the general quality of legal institutions.

All indicators are standardized with a value of 0 in 1996, 1 year before the eruption of the banking crisis. An increase in indicator values means improvement while a decline means deterioration. In each figure, both the world average and the developing country average are also plotted for comparison.

Figure 15.2 plots changes in regulatory quality indicators. It shows that the Republic of Korea and Japan are the only countries to have experienced improvements in regulatory quality, achieving +13 points and +5 points, respectively in

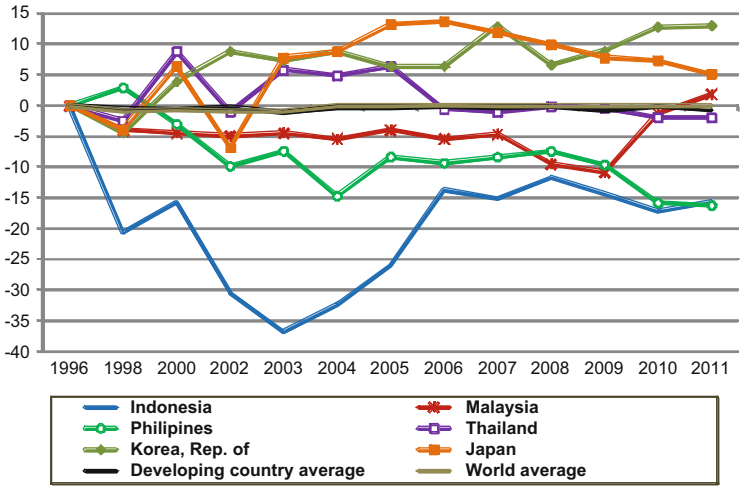

Fig. 15.2 Changes in regulatory quality indicators (1996 = 0). *Source*: World Bank, *Worldwide Governance Indicators* (2012)

2011. Indonesia's deterioration until 2003, down to −37 points relative to 1996, is remarkable, although the indicator improved significantly afterwards until 2006. The initial deterioration is not surprising, because the period up to 2003 includes both the last years of the authoritarian rule of Suharto, when much decision making was governed by ad hoc decrees rather than by democratically legitimized regulations, and the period of trial and error typical of the discovery process of post-Suharto democratization. The eventual improvement appears consistent with increasing consolidation of democracy in Indonesia. The Philippines experienced persistent declines over time. Indonesia and the Philippines converged to a similar level in 2011, recording −16 points. Thailand experienced moderate improvement in early years but later saw modest deterioration. In contrast, Malaysia experienced deterioration until 2009 but began to improve afterwards, particularly during 2010–2011. These two countries recorded values close to zero (+2 points for Malaysia, −2 points for Thailand) in 2011, in line with the world and developing country averages. The focused reforms of the banking and corporate sectors in the emerging Southeast Asian countries in response to the Asian financial crisis may have been too specific to impact the broadly defined spectrum of the regulatory quality index more strongly.

Figure 15.3 plots changes in rule of law indicators. The figure shows that only the Republic of Korea experienced significant improvement over time, recording +11 points in 2011. Surprisingly, Japan saw modest deterioration, recording −4 points in 2011. Malaysia saw modest deterioration up to 2000, modest improvements until 2004, and then modest deterioration afterwards, reaching +1 in 2011, a better performance than the world and developing country averages. Indonesia, the Philippines, and Thailand experienced significant deteriorations in rule of law indicators. As in the case of regulatory quality, Indonesia saw remarkable

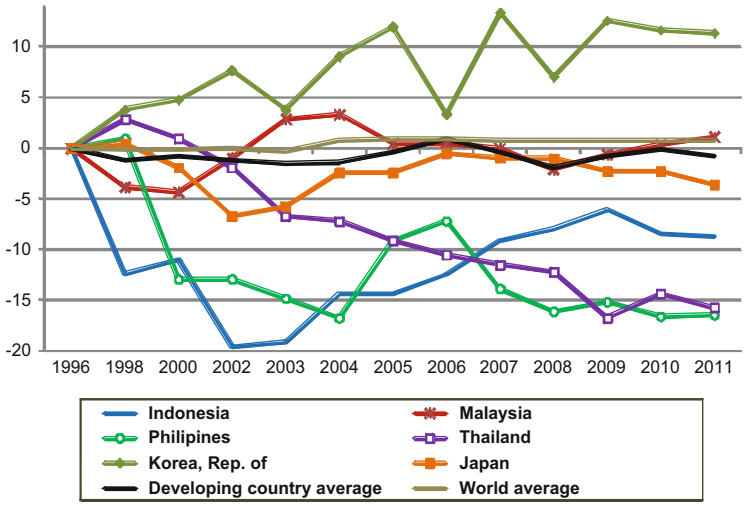

Fig. 15.3 Changes in rule of law indicators (1996 = 0). *Source*: World Bank, *Worldwide Governance Indicators* (2012)

deterioration up to 2002–2003, reaching almost −20 points, and substantial improvements in subsequent years, recording −9 points in 2011. The Philippines saw deterioration in 2000 and did not recover much afterwards, while Thailand experienced steady deterioration over time. In 2011, these last two countries recorded the same level of −16 points.

Given the wide spectrum of the rule of law concept, changes in the indicators may well have been impacted by political and social events, such as the repression of political and social upheavals in Indonesia in 2002–2003 (in Timor-Leste until its independence in 2002 and in Sulawesi, Aceh, South Kalimantan until 2003): unrest in the Philippines (Mindanao) since 2000 until today; and in Thailand the violent eruption of long-simmering social tensions between yellow shirts (anti-Thaksin forces) and red shirts (pro-Thaksin forces) that started in 2006. As the rule of law indicator covers an even broader spectrum of legal areas at a much higher level of generalization than the regulatory quality indicator, it is not surprising that banking and corporate sector reforms in response to a financial crisis are crowded out by the overriding political and social developments just mentioned. The reforms of civil procedure and of judicial structures in the Southeast Asian countries discussed in Sect. 15.4 affect the broadly defined rule of law index, as they have an impact on access to justice. However, as we have seen, these reforms require much higher public investments and longer time horizons than regulatory reforms. Hence, it is too early for the indicator to pick up their effects.

Figure 15.4 plots changes in control of corruption indicators. The figure shows that Japan and the Republic of Korea made improvements over time, recording +6 points and +5 points, respectively. In contrast, Southeast Asian economies experienced deterioration, particularly relative to the developing world average, which

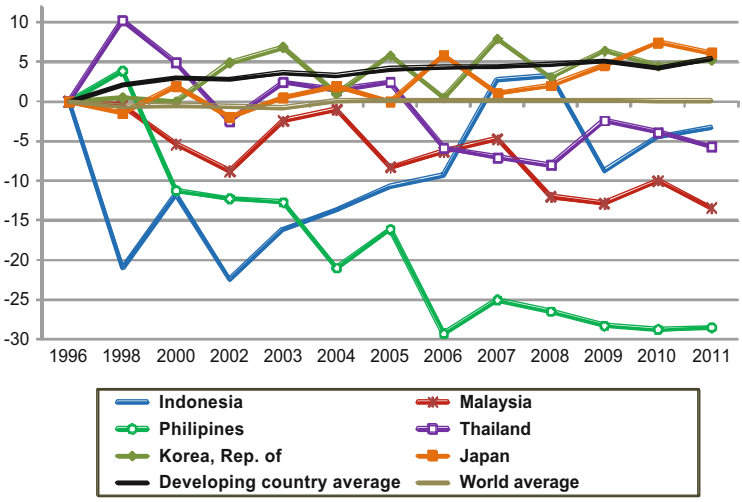

Fig. 15.4 Changes in control of corruption indicators (1996 = 0). *Source*: World Bank, *Worldwide Governance Indicators* (2012)

made a steady improvement over time. The Philippines is the worst performer recording −29 points in 2011, followed by Malaysia (−13 points), Thailand (−6 points) and Indonesia (−3 points). In the case of Indonesia it is noteworthy that there appears to be a significant degree of covariance between consolidation of democracy reflected in the rule of law indicator (Fig. 15.2b) and the control of the corruption indicator.

To summarize, the Republic of Korea stands out by exhibiting consistent improvements in all three categories of regulatory quality, rule of law and control of corruption. Japan shows improvements in regulatory quality and corruption control, but not in rule of law. Malaysia demonstrates slight improvements in regulatory quality and rule of law, but a significant deterioration in corruption control. In contrast, Indonesia, the Philippines, and Thailand show significant worsening in all the categories, although the Indonesian case signals a positive trend—after experiencing remarkable deterioration—possibly reflecting the progress of democratization. The Philippines is the worst performer, followed by Indonesia.

The hypothesis of the paper is that the quality of legal institutions in the areas of banking, corporate and bankruptcy law as well as civil and commercial law has improved following the legal and judicial reforms achieved in the period after 1998 to resolve the financial crises. However, the mixed results for the six countries based on the three Worldwide Governance Indicators do not appear to support the hypothesis at first sight. Only when we take account of the different levels of analysis and time horizons of the legal reforms induced by the financial crises and of the nature of the Worldwide Governance Indicators can we better understand the mixed findings.

15.5.2 Interpretation of the Mixed Findings

The six crisis-affected countries went through significant and similar legal and judicial reforms important for financial, commercial and civil transactions. There are several conceivable explanations as to why the three Worldwide Governance Indicators show improvements in some countries and not in others. These include: (1) the indicators with their large variety of data inputs cannot fully capture the impact of the type of legal reforms triggered by the financial crises; (2) the reforms were not comprehensive and effective enough—particularly in Southeast Asian countries—to impact those countries' performance; (3) the reforms were so fundamental that longer time horizons would be needed in most Southeast Asian countries; and (4) intervening political and social disruptions affected the results more than the legal and judicial reforms in some countries.

The strong achievements observed for the Republic of Korea and Japan can be attributed both to the quality of their codified substantive contract law (Boucekkine et al. 2010) and to the procedural efficiency of their judiciaries. As explained in Sect. 15.2, the Republic of Korea codified its civil law system autonomously half a century ago. Japan has benefited from a similar system for seven decades longer. In both countries, civil procedure is managed by highly educated and trained judges who provide their knowledge as a public good. Judges and lawyers are trained together as in Germany and Switzerland (Schmiegelow 2013) and maintain high standards of independence, integrity and public trust (Haley 2007). These are the essential factors behind the strong performance of these two countries. The average disposition time for claims of unpaid debt worth 50 % of GDP per capita in Japan (60 days) and the Republic of Korea (75 days) is the shortest in Asia (Djankov et al. 2007).

Among developed countries, Japan's litigation rate is very low. This may be partly due to the adoption of the American and French rule on court costs and on the allocation of lawyers' fees between the litigating parties, which leaves each party with its own lawyers' fees. The American rule has been criticized as a serious impediment to access to justice for seekers of judicial relief with justified cases (Reimann 2012; Maxeiner 2010). The reluctance of Japanese lenders and borrowers to jeopardize their relationship by going to court over NPLs may also have been one of the reasons for the slow recovery from the banking crisis in the previous years. One of the reasons why Japan lags behind the Republic of Korea in improving the regulatory quality indicator may be because of Japan's slower pace of economic deregulation, as the Republic of Korea made substantial progress following the 1997–1998 financial crisis.

Even though substantial legal reforms in financial, commercial, and civil areas were pursued in Indonesia and the Philippines, their positive effect seems likely to have been crowded out by negative data inputs in areas of constitutional law and human rights violations (Timor-Leste, Aceh, Sulawesi, and South Kalimantan in Indonesia and Mindanao in the Philippines). At the same time, these two countries

do have serious problems in the area of judicial enforcement of law, which is a critical determinant of the quality of legal institutions.

Reforms in economically crucial areas of substantive law will remain mere "law on the books" without efficient enforcement through procedural law and effective judicial supply (Schmiegelow 2013, and Chap. 5). As illustrated by the case of India in the five decades since independence, changes in *de facto* judicial supply involve much higher costs and take much more time the *de jure* legislative changes of substantive law (Badami and Chandu in Chap. 7, Deakin and Sarkar 2011). The effectiveness of reforms in substantive law depends on procedural efficiency. Seen from the point of view of the effectiveness of the judiciary, this is a particular challenge for the Philippines and Indonesia as well as, to a lesser extent, for Thailand and Malaysia. These countries continue to be plagued by procedural inefficiencies such as low density and funding of subordinate courts, long disposition times and clearance rates resulting in sizable case backlogs.

The cross-country study of the duration of civil procedure (Djankov et al. 2007) suggests that the Philippines and Indonesia have a long way to go in developing their respective judicial supply. The enforcement of a contract of unpaid debt worth 50 % of GDP per capita takes an average of 570 days in Indonesia, which is the worst of the six Asian countries studied here, and 380 days in the Philippines, in contrast with record low numbers in the Republic of Korea (75 days) and Japan (60 days). All four countries have judicial systems based with civil law origins. Just as in the overwhelming majority of former colonies of Western powers, Indonesia, Malaysia, and the Philippines may still be suffering from the "transplant effect" of the imposition of a culturally foreign legal system on non-receptive countries which had previously had local customary traditions (Schmiegelow 2013). The three countries (as well as Thailand) clearly need to improve the functioning of their court systems and civil procedure further.

That Indonesia is one of the worst performers in terms of changes in the quality of legal institutions should come as no surprise. As noted above, the catalytic effects of the financial crisis were overtaken and magnified by the much more fundamental process of democratization and decentralization after the end of the Suharto regime in 1998. The expansion of the judiciary required by the decentralization process involves public investments in judicial infrastructure, recruitment, and training that far exceed those faced by Malaysia and Thailand. The rule of law indicator may not fully capture the initial complexities of such processes of simultaneous democratization and decentralization. Nonetheless, significant improvements in Indonesia's indicators since 2003–2004 appear to reflect the gradual consolidation of democratization and decentralization.

Malaysia's performance was the best among the Southeast Asian countries in raising the quality of legal institutions, although it still faces the challenge of improving the efficiency of its justice system. In 2007, it still took an average of 300 days to enforce a contract of unpaid debt worth 50 % of GDP per capita in Malaysia, far longer than in Japan and the Republic of Korea (Djankov et al. 2007). As explained in Sect. 15.4, taking control of the progress of a case out of the hands of attorneys and giving it to the court was suggested by the World Bank (2011), but

this would entail a fundamental change from the traditionally lawyer-dominated common law procedure to the traditionally judge-managed civil law procedure (Kaplan et al. 1958; Langbein 1985; Schmiegelow 2013). An essential requirement for such a change would be for the judges to develop their function from that of an arbiter of the contest between lawyers presenting unlimited arguments of fact and law to that of a manager of procedure, narrowing issues, separating relevant from irrelevant facts, and supplying legal knowledge as a public good according to the principle *iura novit curia*—"the court understands the law" (Schmiegelow 2013). To do this, an entirely new system of education, training and remuneration of judges, especially at the first instance level, would be needed. The legislative branch will have to contribute the budgets as well as the basic principles of legal education and training of future generations of first instance judges. Japan and the Republic of Korea offer excellent models of joint training of judges and lawyers.

As explained in Sects. 15.2 and 15.4, Thailand autonomously began developing its own civil law system by legislating a code of civil procedure in 1908. Hence its procedural efficiency should be less of a fundamental challenge than in Malaysia. However, like many other developing countries including Malaysia, Thailand has also suffered from the neglect of subordinate courts in the sense of insufficient public investments in education and training, as well as in status and pay, of first instance judges. The average disposition time for claims of enforcement of a contract of unpaid debt worth 50 % of GDP per capita is 390 days (Djankov et al. 2007). As reported in Sect. 15.4.3, the Thai judiciary has recognized the need to improve procedural efficiency, but the emergence of partisan divisions in Thai society and politics between "yellow shirts" and "red shirts" (Charoensin-o-larn 2013) has made such structural reforms more difficult in the short term. This remains an undertaking for the long term.

To summarize, what matters for improvements to be made to the quality of legal institutions is not only the reform of substantive law related to economically crucial areas but also the enforcement of law, procedural efficiency, and other political and social developments that may affect the results. Japan and the Republic of Korea stand out as countries with highly developed judiciaries, although they are known for widely diverging litigation propensities: Japan has an unusually low level of litigation (often interpreted as a cultural abhorrence of jeopardizing established relationships as reported with further references by Schmiegelow in Chap. 5) while the Republic of Korea has a high level of litigation (Lee 2010). Indonesia, Malaysia, the Philippines, and Thailand are challenged by procedural inefficiencies that have been aggravated by fundamental political transformation or political and social cleavages. As emphasized by Pistor and Wellons (1999), legal reforms have not been adequately supported by training, status and pay for judges and other legal professionals in these poorly performing countries as in most developing countries. Moreover, reforms of *de facto* judicial structures take much longer than legislative changes to *de jure* substantive laws. Long time lags, perhaps in the order of several decades, may be needed to observe the tangible contribution of legal reforms.

15.6 Conclusion

This paper has examined the experience of legal reforms to facilitate bank and corporate restructuring in six crisis-affected Asian countries. Legal and other related reforms were pursued to resolve the financial crises and put their economies back to sustained growth paths. Bank and corporate restructuring was the first priority for these economies.

Restructuring of banks and their balance sheets required restructuring of their corporate clients as the banks' difficulties were due to NPLs to their corporate borrowers. Banks had to have adequate capital to set the stage for aggressive restructuring of NPLs on their balance sheets and thus corporate restructuring. Government recapitalization programs, conditional on some costs falling on bank owners but without jeopardizing their willingness to recognize losses, played critical roles. At the same time, corporate restructuring required creditors (such as domestic banks and international creditors) and debtors (corporate borrowers) to have the right incentives to preserve their assets and to manage their businesses efficiently. With such incentives, creditors were then able to judge whether, when, and how to restructure their debt claims so that corporate borrowers would operate their businesses efficiently and repay what they owed. Although agreements were encouraged to be voluntary, a credible threat of bankruptcy had to be introduced in order for a voluntary process of corporate restructuring to work. The alternatives to an agreement had to be made clear and credible so that creditors could enforce their legal claims through formal, court-based bankruptcy procedures. Mechanisms were introduced to provide borrowers with incentives to agree to a restructuring by subsequently making working capital financing available. Thus, legislative, judiciary, and executive branches of government played a proactive role in resolving systemic financial crises by strengthening, or establishing if necessary, the legal and institutional frameworks supporting corporate restructuring and policies to improve corporate governance.

Legislators, judges and government ministries in the six crisis-affected countries utilized the crisis as an opportunity to undertake legal, judicial and other reforms and to improve the overall legal environment of the countries. Except in the Republic of Korea and, to some extent, Japan and Malaysia, there is as yet no reliable evidence that these reform efforts actually led to improvements to the legal and judicial institutions in these countries. The four Southeast Asian countries faced the challenge of enforcing new laws and judicial practices under various conditions of fundamental political transformation, separatist political upheavals, supervening social cleavages, or structural lack of capacity, incentives and oversight. But the fact remains that the six countries did embark on ambitious reforms in remarkably similar ways in response to their financial crises. That their economies recovered from the crises quickly (except in Japan) means that at least the reforms of their immediately concerned economic laws were not a wasted attempt.

That the six countries underwent similar experiences of crisis response, resolution and legal reforms can be partly explained by the fact that the same IFIs—the

IMF, the World Bank, and the Asian Development Bank—assisted most of them in bank and corporate restructuring. They provided not only loans but also advice on international best practices of bank and corporate restructuring and legal, judicial, and institutional reforms. Japan was the only country that was not assisted by these IFIs, but it quickly adopted similar best practices of legal reforms.

We have argued that reforming substantive law alone cannot improve the quality of *de facto* legal institutions. What matters is the effective enforcement of law with procedural efficiency and easy access to justice. In the cases of Indonesia, the Philippines and Malaysia, the "transplant effect" of Western legal systems may have made the implementation of laws a significant challenge. In Indonesia, the supervening democratization and decentralization since 1998 have enormously magnified the task of improving the judiciary. In Thailand, political conflict has created social cleavages, which has resulted in additional burdens for a judiciary in the midst of very fundamental reforms. Such political and social transformations pose challenges in designing the rule of law indicator. Long time lags, perhaps in the order of several decades, may be needed to observe the transmission of legislative change of substantive laws "on the books"—through efficient civil procedure or alternative dispute resolution—into applied, practiced law, which can serve as a reliable framework for markets.

These experiences suggest several conclusions.

- First, the financial crisis accelerated the process of convergence of legal systems between civil law countries and common law countries. Scholars of comparative law have recognized this for a long time, finding ever more legislation in common law countries and ever more judge-made laws in civil law countries. But so far, they have barely focused on the ways in which economic factors can promote such convergence.
- Second, the similarity of crisis responses in countries with very different legal origins is a challenge to legal origins theory, which works with simplified codings of countries as either common law or civil law and would have predicted superior outcomes in common law countries compared with civil law countries. Moreover, this theory did not envisage financial crises in common law countries and would not have recommended proactive government policies for crisis resolution.
- Third, the debate on the relationship between law and economic development can draw comfort from the interest and proactive responses of legal scholars and members of the judiciaries in developing countries affected by financial crises. This would not have been anticipated from skeptical views of the readiness of entrenched legal systems of developing countries for legal reform.
- Finally, leading cross-country indicators of regulatory quality, rule of law, and corruption control are certainly suggestive guides for problem detection. But questions remain as to whether they accurately capture the transmission from substantive law through civil procedure to applied, practiced law in different areas. A careful and transparent weighting of the relative importance of various areas of law may be needed for global governance indicators. Strategies for legal

reforms and measures of their success can only be provided by detailed analysis of the evolution of both substantive and procedural laws as well as of judicial structures. Data for the four Southeast Asian countries support the view that changes in *de facto* judicial supply involve much higher costs and take much more time than *de jure* legislative changes of substantive law or executive measures of bank and corporate restructuring.

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Chapter 16
Overcoming the Civil Law/Common Law Divide by Integration: The Case of OHADA

Grégoire Bakandeja Wa Mpungu

16.1 Introduction

This chapter examines how institutional competition between French Civil Law (Continental or Romano-Germanic) and English Common Law legal origins can be analyzed in terms of their functional suitability and potential in the processes of integration among developing countries desiring to reform their legal systems. My thesis is that the Organisation pour l'harmonisation en Afrique du droit des affaires (Organisation for the Harmonization of Business Law in Africa) (OHADA) can be considered as textbook case of the creation of a new legal system transcending the divide between common law and civil law.

OHADA is an organization of currently 17 member states, principally francophone, in a continent facing many challenges, in particular poverty and underdevelopment. Legal and judicial insecurity are among the causes of these challenges. OHADA's approach is to address these legal deficiencies by the building of a new, effective and efficient legal system in the field of business law (Paillusseau 2004b) designed to facilitate business and offer procedures for resolving disputes inherent to the exercise of economic activities across national borders (Cerexhe 1978). The member states are 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 (DRC).

Although inspired by the French legal origins of the majority of its current member states, OHADA law appears to overcome the opposition between civil law and common law by offering original and practical solutions to international actors. Cameroon has set a significant example as a bilingual country that applies OHADA law by integrating certain practices inherited from Anglo-Saxon law. This

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is one of the reasons that may explain the enthusiasm of some English-speaking African countries for the OHADA (such as Ghana and Nigeria), today at its doorstep.

OHADA is both an international organization and a Treaty. As an international organization it has set itself the goal of integration and especially unification of business law in the Member States. As a Treaty concluded between the Member States, it commits the contracting parties to this process.

In the narrow sense of its name, the OHADA was established to "harmonize" the laws of the Member States in the field of business law. But in reality its goal is to unify the business law of the organization's member countries. This unification is achieved essentially by two means: the adoption and promulgation of "Uniform Acts" applicable in all member countries, and the institution of a Common Court of Justice and Arbitration to ensure unified business law across the member countries.

The Uniform Acts are actually uniform laws. They cover different areas of business law including general commercial law, the law of commercial companies and economic interest groups, guaranty law, a law on simplified collection of receivables and rights of recourse, bankruptcy law, arbitration law, accounting law, and a law on contracts for the road carriage of goods. A Uniform Act on labor law should be adopted very soon. Discussions are continuing to further enlarge the areas covered.

The particularity of these Uniform Acts is that they are directly applicable in all Member States. They override pre-existing national legislation insofar as the provisions of these laws are contrary to those of the Uniform Acts.

It is undeniable that the economic development in Africa can only be achieved with a secure and attractive legal framework for investment. With regard to the disparity in legislation in French-speaking countries at the time of their independence, the unification of their business law must be a priority.

The primary role of OHADA is therefore to serve as a means of strengthening the legal and judicial security in its area of application in order to assist development progress by consolidating secure investments and economic integration through a unified business law. In accordance with the provisions of article 1 of the Treaty of Port-Louis (1993), the objectives of OHADA are to harmonize the business law of the Member States "by the development and the adoption of simple common rules, up-to-date and adapted to their economic situation", to establish and promote arbitration for the settlement of contractual disputes, to improve the investment climate, to support African economic integration, to promote the establishment of an African economic community, and finally "to achieve further progress on the road to African Unity".

In this way, the main mission of OHADA is to create a system of business law that can be applied in the same way in all the Member States, confirming its international character (Bakandeja wa Mpungu 2010).

As you will be aware, this is a sharp departure from the legacy of transplants of legal systems of the former European powers to their respective African colonies and territories. Thus, in the area of business law, mainly French commercial and corporate law was extended to many African countries. This extension led to a

certain unification of the law in the countries concerned. After independence, most of the countries simply retained this law as it was, without actually adapting it to the changing economic situations and needs of local businesses. As a consequence, it became clearly obsolete. In France, as in most Western countries, business law is subject to constant revision. The texts change continually because the world keeps changing. In many African countries, reforms were made in certain areas, but independently of any that were made in other countries. Continuing pressure tended to splinter formerly unified law.

This being so, we must now return to our primary concern, whether or not OHADA law ensures a better access to justice.

While OHADA legislation of substantive business law directly applicable in Member States highlights the method of regional integration as a strategy of legal reforms in developing countries, it is important to understand it as a unique legal construction, quite distinct from the European model of integration (Sect. 16.2). Similarly unique is the institution of OHADA's Common Court of Justice and Arbitration (CCJA), which serves both as a third instance court of cassation with the power to review rulings of courts of appeal and other courts of Member States and as a court of arbitrage for the settlement of disputes arising from cross-border business operations (Sect. 16.3). Just as in Europe however, tensions between supranational and national jurisdictions persist. Uncertainties may also arise when CCJA judges have to decide on conflicts between the laws of OHADA and other international organizations asymmetrically overlapping with OHADA, such as the West African Economic and Monetary Union (UEMOA) or the Economic and Monetary Community of Central Africa (CEMAC) (Sect. 16.4).

16.2 The Distinctive Design and Functioning of OHADA Business Law

The business law of OHADA is a law with unique characteristics (Paillusseau 2004a). The originality of OHADA law is clearly seen through its features to ensure efficiency (Sect. 16.2.1). But the coexistence of different laws within the OHADA community imposed within the area reduces the scope of this functional advantage by some degree of legal uncertainty (Sect. 16.2.2).

16.2.1 Factors of Efficiency

Three distinctive elements in the design of OHADA business law serve the purpose of guaranteeing the efficacy of justice: law making for a common legal space, the supranational design of principally unified and accessorily harmonized laws, the concept of business law in a wide sense, including labor law.

16.2.1.1 A Law for a Common Legal Space

On principle, the adoption by different countries of a common business law should be both a condition and a consequence of the building of an economic union and, a fortiori, of an economic and monetary union between these countries. Evidently, one should think, such unions cannot really function, if their member states do not have unified, or at least harmonized, laws in essential areas of economic activities. For example, as the Europeans had well understood, a common market could not be effective without member states applying some common legal rules. More particularly, the European directives in the field of corporate law follow this logic. In some areas, it became necessary to legislate unified European law such as in the fields of competition and concentration of enterprises. To that end it was necessary to build the required legal institutions and procedures. Moreover, the Court of Justice of the European Union was established.

However, it was not the creation of such an economic union that led to the harmonization of business law in the OHADA space. The countries of the OHADA space belong to different economic and monetary unions. And these unions have laws of their own in some areas of their economic activities, more particularly in the area of competition.

As an illustration, eight of OHADA's West African member states are also members UEMOA, which they established with a view to creating a common market within a customs union permitting the free movements of goods, services, capital and persons. This union did initiate a process of harmonization in different fields of the legislation of its member states and more particularly in the areas of banking and competition.

Another economic community in West Africa, the Communauté économique des états de l'Afrique de l'Ouest (Economic Community of West African States) (CEDEAO) has the goal of building an economic union in West Africa. It comprises the member states of the UEMOA in addition to Guinea (Conakry) and five Anglophone countries, which do not belong to OHADA (Gambia, Ghana, Sierra Leone, Nigeria and Liberia).

There is a similar organization in Central Africa, the Communauté économique et monétaire de l'Afrique Centrale (CEMAC). Its members include six of OHADA's Central African States: Cameroon, Central African Republic, Chad, Republic of Congo (Brazzaville), Equatorial Guinea, and Gabon. CEMAC, in turn, established two unions: the Union Économique en Afrique Centrale (UEAC) and the Union monétaire en Afrique Centrale (UMAC). The objectives of UEAC are rather similar to those of UEMOA. UEAC has developed a competition law regulating domestic commercial practices as well as state practices affecting cross-border commerce. UMAC essentially regulates foreign exchange transactions and banking.

Hence, OHADA is obviously not a mere product of a process of integration of an existing economic and monetary union, with which it would fix the rules of the game. It is, as it were, an independent variable, arising from the determination of

the founding member states to set common legal rules in specified areas for the entire West and Central African region. It is a common legal space. It is neither a mere intergovernmental conference nor a federation. It is a model of legal integration.

One might be concerned about risks of conflict of OHADA laws and UEMOA or CEMAC laws in certain areas, such as banking operations or the accounting rules of OHADA and UEMOA (SYSCOA) respectively (Sawadogo and Ibriga 2003). In fact, however, the areas of law for which the different regional organizations have competence are well circumscribed and in practice there do not seem to be problems of conflict of laws.

16.2.1.2 A Law Principally Unified and Accessorily Harmonized

In spite of its name, OHADA's main function is not to "harmonize" the business laws of the states, which are contracting parties to the Treaty, but to unify them (Kirsch 1998). The norms of a uniform Act legislated by OHADA in whatever area, apply directly in the same way in all states of the OHADA space.

It is evident that for an enterprise doing business in several countries, the unity of applicable legal rules eases operations considerably, whether they concern the organization of the firm, its functioning or its commercial and financial transactions. Unification also offers advantages in terms of public goods, such as legal research, teaching, publications and exchanges between academics and practitioners of the laws of the member states (Issa-Sayegh and Lohoues-Oble 2001, 2002).

To be sure, one might fear that as times passes the application of the same rule—of the same text—may give rise to different interpretations depending on the country and the court chosen by a claimant. But the drafters of the Treaty did foresee this risk. They have provided for a supranational jurisdiction, the CCJA. It can be consulted by national courts, if they have to decide a case governed by OHADA law, and it can decide as instance of last resort on appeal against rulings of national courts. This is how the CCJA guarantees legal unification.

As opposed to the European method of "directives" intended to harmonize the laws of the member states of the European Union already achieved, the OHADA law attains a unification of business law, thereby offering a better access to justice for businesses with cross-border operations. While harmonization may have the positive aspect of permitting, to a certain extent, the adaptation of common rules to specific national circumstances, it also entails risks of perverse effects. For example, in the name of institutional competition with the aim of attracting investors, national legislators may seek ways to exempt certain categories of businesses from community rules.

However, the notion of harmonization was not entirely discarded by the OHADA legislator. The Treaty defines certain areas, for which national legislators retain competence as long as uniform Acts do not withstand. For example, Article 5 Section 2 of the Treaty specifies that uniform Acts may include penal provisions. The contracting member states commit themselves to determine the penal sanctions.

16.2.1.3 A Business Law in the Wider Sense, Including Labor Law

From the beginning and as indicated expressly in the Treaty's title, the legal area to be covered by OHADA was business law ("droit des affaires"). The delimitation of this area of business law may be the subject of discussion (Mouloul 2005). The OHADA legislator has defined in a wide sense by including fields such as labor law. As Jean Paillusseau (2004b) writes:

> It is difficult to assert that labor law is part of business law, even if that assimilation is sometimes done. Moreover, the term 'business law' does not designate in a legal or academic sense any category of persons, firms or corporations, as does corporate law or competition law. If the term has a great success in the second half of the 20th century, it is essentially because it released the entire modern law governing enterprises and their relations from the far too narrow und culturally non-adjusted notion of commercial law. The term is convenient and widely used. What its texts cover, is in fact a large part of the law of economic activities. The real object of the institutional framework achieved by OHADA texts is this or that economic activity. Or the task is the organization of individual or corporate persons themselves, which is the object of other uniform Acts. Labor law is mostly concerned with economic activities. Employees are involved in the production, transformation and distribution of goods and services and the rules of labor law are designed to organize their status in the enterprise and their relations with the enterprise.

16.2.2 Competition and Complementarities with Community Laws of Other Regional Organizations

The asymmetrical overlaps of supranational and community laws of various regional organizations results in a certain degree of legal uncertainty, although in theory these laws are supposed to complement each other. In certain cases they do indeed.

16.2.2.1 Friction Between Overlapping Legal Communities and Legal Insecurity

Evidently, the coexistence of several economic communities the member states of which are also contracting parties of the OHADA Treaty and the relations each of these communities entertain independently with OHADA make the connection between these organizations problematical. This should not be surprising, since two different categories of international organizations overlap in sometimes identical spaces on which they impose legal rules governing identical or connected subject matters without an always perfect coordination. In this context African countries have been blamed for entering regional organizations without prior articulation of the necessary coherence with previous commitments, the result resembling "millefeuilles" (Priso-Assawe 2010).

16.2.2.2 Complementarities

The laws of the economic communities and OHADA's uniform law are conjugated in terms of the area of application of their rules. We can consider that harmonized laws are destined to modernize national laws, which means that their purview is national. The area of application of community laws would be defined by the community dimension, within which, again, national laws are applied (Cistac 2007; Cavalier 2007). In this hypothesis, harmonized laws and community laws are conjugated with the objectives of modernization declared on both levels (Martor et al. 2009; Tiger 1999). This formula could be applied, for example, to regulations of competition. In the CEMAC zone, the community regulation of competition is applicable only if certain thresholds and criteria defined by community law are met (Priso-Assawe 2010). However, if communities laws claim exclusive application as asserted by an opinion of the UEMOA Court of Justice in a case concerning competition law (Recueil CJ UEMOA 2000), the question becomes much more complicated and suggests the hypothesis of friction between overlapping legal orders which I shall discuss below.

16.3 OHADA Jurisdiction and Arbitration

Access to justice in the framework of OHADA is best analyzed in terms of the institutions established by the OHADA Treaty for the purpose of resolving business disputes in a way to combat the judicial insecurity lamented until then in member states as an impediment to investment.

In fact, the particularity of OHADA law is to have instituted both original rules of arbitration in order to resolve commercial disputes on a continent considered by many international operators as lacking the necessary legal security for developing economic activities and a common court of justice and arbitration, the CCJA, as a supranational instance of cassation of rulings of national appeal courts and other national judicial institutions (Actes 1993, 1998, 2010).

As Feneon (2007) writes: "The consecration of arbitrage as the normal mode of resolution of commercial disputes by the Treaty is a major event for enterprises and the counsels working habitually with, or on, the African continent".

The OHADA Treaty institutionalized arbitrage and entrusted it to a unique institution, the CCJA, a supranational organ with its seat in Abidjan, with powers to both organize arbitration and to control rulings of national judiciaries as an instance of last resort (Pilkington and Thouvenot 2004). Beyond this supranational arbitrage institutionalized by the Treaty, the uniform Act provides common rules for the member states concerning both the subject matters of arbitration and the arbitral procedure, judicial remedies, as well as the recognition and enforcement of rulings.

In conformity with article 1 of the uniform Act, OHADA law applies to all arbitrage organized at an arbitral tribunal established in one of the member states. In its function as a supreme court, the task of the CCJA is to unify the jurisdiction and the interpretation of the uniform Acts. For that purpose it was given both judicial and consultative powers.

We should note the further precision brought by article 14, paragraph 1 of the revised Treaty, which states that the CCJA "ensures the common interpretation and application of the Treaty as well as the regulations issued for its application, of the uniform acts and of its rulings".

16.3.1 The CCJA as an Institution of Appeased Justice?

Without any doubt, the OHADA Treaty leaves the contentious jurisdiction concerning the application of the uniform Act to the levels of first instance and appeal to the member states (Art.13 of the Treaty). Yet, the Treaty also intended to satisfy the demand for an alternative avenue to dispute resolution guaranteeing justice, impartiality and with equity (Actes 1993, 1998, 2010).

For that purpose, the OHADA aimed at promoting arbitrage as a mode of dispute resolution in the field of contracts. It has established the CCJA as an institution with the double function of jurisdiction of last resort in charge of integration of the uniform application of the Treaty and its derived acts as well as of a forum of arbitrage and a center of administration of arbitration procedures requested by parties of contractual disputes.

Hence one may say that the CCJA plays a crucial role in the OHADA mission of guaranteeing justice in its space. I shall evaluate this role of the CCJA in its jurisdictional functions (Sect. 16.3.1.1) as well as in its arbitral function (Sect. 16.3.1.2).

16.3.1.1 Jurisdictional Functions of the CCJA

As a judicial institution, the CCJA deals with contentious jurisdiction as well as consultation.

Contentious Jurisdiction

The CCJA hears cassation appeals in any dispute concerning OHADA uniform law. The national jurisdictions of member states decide in these matters on the levels of first instance and appeal.

The Court may "rule on the decisions pronounced by the appellate courts of Contracting States in all business issues raising questions pertaining to the application of Uniform Acts and to the Regulations provided for in the present Treaty,

save decisions regarding penal sanctions pronounced by the appellate courts" (Art 14 of the Treaty). Such final cassation appeals may be brought to the Court "either directly by one of the parties of the proceedings at a lower instance or by referral of a national court ruling on appeal on a case to which it is referred and which raises questions concerning the application of the Uniform Acts" (Art 15 of the Treaty). The hearing of a case on appeal by the Court automatically stays all proceedings in view of instituting an appeal before a national court against the decision in question. However this rule does not interfere with procedures of enforcement (Art 16).

The CCJA may also be referred to by the government of a member state or by the Council of Ministers of the OHADA.

The obligation for parties seeking cassation of a ruling by a national court of appeal in matters involving the application of uniform Acts means that member states have abandoned a part of their sovereignty to the OHADA. This same obligation also has the added benefit of furthering the unification of the jurisdiction of the courts in the OHADA space (Guyon 2004). As T.G. de Lafon wrote (1995), "a uniform law calls for a uniform jurisdiction". As mentioned above, and further explained below, the CCJA also contributes to such harmonization by a further means, i.e. by consultative opinions upon referral.

The proceedings at the CCJA are adversarial in nature and, in principle, written. Each party must be represented by a qualified lawyer. The hearings are public.

a. When the Court pronounces a cassation, it immediately rules on the cause without referring the case back to a national court of appeal for further decision on the cause. This means that the CCJA constitutes a jurisdictional instance in its own right. Does this amount to a third instance above the two instances on the national level? One is tempted to respond in the affirmative. This institutional design saves time for the parties, who do not have to return to a national court of appeal for a renewed procedure.
b. It is important to note that CCJA rulings have non-appealable authority and are binding effective the date of their pronouncement. They are enforceable on the territory of each member state pursuant to the rules of civil procedure of the member state concerned. In this way the rulings of CCJA are assimilated with national jurisdictional decisions with all the consequences resulting from that assimilation. In each member state a writ of execution is attached to the rulings of the CCJA after control of the authenticity of the title by an authority designated by the government of the member state concerned.

However, extraordinary appeals are possible against the rulings of the CCJA: third-party claim, request of interpretation of the operative provisions of the ruling or petition in suggestion of error.

Consultative Functions

Art 14, paragraph 2 of the Treaty states the principle of the consultative role of the CCJA. More particularly, the CCJA may

- render an opinion on a draft of a uniform act before its submission to the Council of Ministers;
- interpret uniform Acts and orient their application in the member states
- interpret the Treaty and the regulations issued for its application
- render consultative opinions upon request of member states, the Council of Ministers or the national judiciaries

Art 53 and following the regulation relating to the CCJA procedure (CCJA rules) determine the modalities of the CCJA's consultative role:

1) If the Court is consulted by a member state or by the Council of Ministers, the request must be presented in a reasoned writ, which the court circulates among the member states enjoining them to make their observations within a fixed deadline. The response of each member state is forwarded to the submitter of the request as well as all other member states having responded. A further deadline is fixed for direct discussion between the submitter and the authors of observations, after which the President of the Court decides whether a hearing should be held.
2) If the Court is consulted by a national court, the Court notifies the parties in litigation of the request as well as the member states enjoining them to submit their observations. What follows is the same procedure as above under 1). This procedure promotes a unified interpretation of the harmonized law. It has the advantage of involving not only the submitters of requests of consultations, but also the member states. In this way, the final interpretation is the result of a consensus emerging from the observations of all participants in the consultative procedure. Hence, its acceptance by all will not be a major problem.

16.3.1.2 The Arbitral Functions of the CCJA

Arbitration is an alternative method of dispute resolution chosen by agreement of the parties of a contract. It is understood as conventional justice, since the parties are free to choose it.

It should be noted that the CCJA does not have the monopoly of arbitration in the OHADA space. There are national arbitration centers in several member states.

There are two types of OHADA arbitrage, one following an institutionalized procedure and one following the default rules of the uniform Act on Arbitration (Traité 1993), if parties to a contract have ad hoc chosen to settle a dispute by arbitration and do not opt for a different procedure. In any case, the choice between the two types is up to the parties.

Institutional Arbitration

The forum for institutional arbitration is the CCJA. In accordance with the Treaty and the regulation on arbitration, the CCJA "accompanies" and administers the procedure.

The prerequisites for this procedure are that either one of the parties (individual person or corporation of either private or public law) of a contract has its domicile or habitual residence in a member state of OHADA or the contract in question is to be fulfilled at least in part in the territory of a member state, and that there is an arbitration clause in the contract or an arbitration bond between the contracting parties to the effect that any dispute arising from the said contract should be resolved by arbitration even if the matter is sub judice in another jurisdiction.

Of course, it is not in the competence of the CCJA to rule in the case, but its function is to nominate or confirm the arbiter(s), to follow the proceedings, and to appreciate the draft of the arbitral award. Mouloul (2008) rightly emphasizes the important administrative role of the CCJA, especially the appointment of the arbiter (s) (in case of disagreement over the nominee; in case three arbiters are necessary; in case no definite number is agreed upon) and the appreciation of the arbitral award.

The arbiter(s) may not sign the arbitral award before having received the CCJA's opinion of the draft.

While the Court's opinion can only propose strictly formal modifications in the draft arbitral award, it does provide necessary indications for the allocation of the cost of the procedure and it does fix the amount of the arbiter's fee.

The arbitral awards have non-appealable authority and, with the exequatur of the CCJA, are enforceable on the territory of each member state (Art 25 of the Treaty). They cannot be subject to opposition nor to appeal by way of cassation Art 25, 1), though in specific cases, there might be a recourse to nullify arbitral awards (Art 26 of AU/DA).

Ad Hoc Arbitration

Ad hoc arbitration is governed by the Uniform Act on Arbitration (1999). It provides default rules for incomplete arbitration agreements between the parties. To the extent that these default rules are not mandatory, the parties are free to determine the rules for the procedure (Fouchard 2004).

16.3.2 The Measure of Judicial Efficacy of Arbitration

The judicial efficacy of the arbitral award can be measured in terms of the effectiveness of the exequatur on the one hand and on the presence or absence of judicial relief in cases of legal deficiencies of the award on the other.

16.3.2.1 The Question of the Exequatur

Feneon (2007) deplores that "while numerous African countries have ratified the New York convention of 1958, its application by African tribunals remains arbitrary as soon as one finds oneself outside the purview of bilateral treaty of judicial assistance, which is generally the case in the relations between Germany and the African countries". Here, art. 25 of the Treaty grants the arbitral award the status of a quasi-jurisdictional decision with full international validity.

This peremptory assimilation is another sign of the Treaty's emphasis on the jurisdictional character of the arbitral award. This is in keeping with Art 1 of the Treaty affirming its legislative intent to harmonize OHADA business law, and more particularly by the encouragement of dispute resolution by arbitration.

Feneon adds a piece of legislative history: "The first draft of the Uniform Act on Arbitration provided for the exequatur to be issued by the (....) CCJA (...) in a specific procedure upon request submitted to a judge delegated by the court".

This provision, in keeping with the spirit of Art 25 of the Treaty, would have had the advantage of centralizing disputes about the exequatur at the CCJA. In this way, the arbitral award with the exequatur apposed would have been immediately enforceable in all member states.

However, in spite of these major advantages, this solution has provoked criticisms from a certain number of national commissions. These commissions, notably the Senegalese, feared losing the contentious jurisdiction on the exequatur, and hence, all control of an award rendered in another state.

Nevertheless, the solution finally adopted by the Uniform Act does not constitute a brake on the enforcement of the award. Indeed, Art 31 of the Act simply provides for effective documentation of the award by the presentation of the original accompanied by the arbitration agreement or of certified copies of these documents.

On the merits, the exequatur cannot be refused unless there is manifest evidence that it is contrary to the international "public order".

In view of common rules like the Convention of the African Union on the prevention of corruption, we may already imagine the sense of this notion and expect that cases of refusal of exequatur will be extremely rare.

16.3.2.2 The Absence of Appeal

The same concern for efficacy is evident in the rules concerning the question of appeal against arbitral awards.

The Uniform Act provides neither appeal to a court of appeal, nor third party claims nor even a cassation appeal. This is a striking departure from the majority of African legislations, which until now recognized such appeals (Meissonnier and Gautron 2008).

Only an annulment is possible, but only on six grounds restrictively enumerated in Art 26:

- if the arbitral tribunal has decided without arbitration agreement or on the basis of an invalid or expired agreement
- if the composition of the arbitral tribunal of the designation of a single arbiter was irregular
- if the arbitral tribunal decided beyond its mandate
- if the adversarial principle was not respected
- if the arbitral tribunal has broken a rule of international public order of the member states
- if the arbitral award does not explain the reasons upon which it is based.

Art 20 of the Uniform Act makes the explanation of the reasons for the award mandatory. The aim of this rule is to protect the right of the defendant in the wider sense, i.e. the organization and the moderation of a fair adversarial debate.

Moreover, the explanation of the grounds is the essence of any jurisdictional decision. Hence, the sanction of annulment is evidently the best means to have it respected.

Hence, explanation is one of the guarantees the Uniform Act provides as part of the rule of law.

16.4 Conclusion

While the institution of a common court of justice and arbitration seems to meet the expectations of economic actors, it has not always found a favorable echo among the member states whose national supreme courts never miss an opportunity to stigmatize any infringement on their sovereignty resulting from the supranational principle enshrined in the OHADA Treaty.

This situation may be understood in view of the wide-ranging competence of the CCJA, which has the power of evocation of cause. The risk of conflicts of competence with other regional organizations founded with the aim of economic and legal integration and establishing their own contentious jurisdictions in fields of their functional purposes is evident. Therefore, one should envisage the passage of appeals of cassation to the CCJA through the respective highest national courts (supreme courts or courts of cassation). There is evidence that decisions of the CCJA on exequatur sometimes meet difficulties on the level of enforcement in certain member states. Similarly one might suggest itinerant hearings of the CCJA in other member states than Ivory Coast where it has its seat. This would reduce the impression of distant justice.

While access to justice has improved as a result of legal integration in the OHADA space, the asymmetrical overlaps with other regional organizations such as UEMOA, CEMAC and others pursuing functional integration in economic and legal fields have the paradoxical effect of fragilizing the legal order and of increasing legal and jurisdictional uncertainty in commercial operations. Just as in the cases of asymmetrical overlaps in other regions of the world, including the

European Union, the Eurozone, and European organizations with specific functional purposes, there is hope that in the fullness of time such problems may be overcome as the realization is made that they may be the price to be paid for the advantages of integration.

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Chapter 17
The Trade Offs Between Common Law and Civil Law: Are We in the Right Ball Game?

Albrecht Stockmayer

17.1 Introduction

"We're all lawyer wannabes," Florencio Lopez de Silanes Molina has been reported saying, which might account for some of the criticism he has come in for (Thompson 2005). The following chapter does not adopt an economist's wannabe perspective. It adopts the viewpoint of advisors on governance and law reforms of the German development cooperation organization (GIZ), i.e. advisors trained in a civil law system but dealing with many systems that follow different paths. And in this capacity we have learned quite a bit from the discussion. And we owe legal origins theory (LOT) a debt of gratitude since the discussion has kept the issue of law reform in the limelight.

On the other hand, we are asking ourselves what this discussion is really all about. Since in many areas common law countries have given themselves a great number of statutes and civil law countries have areas of law that are shaped by case law, it is hard to believe that some of the claims that are associated with LOT publications really stand on their own feet and do not refer to another arena. It is an arena described by some actors as battlegrounds, the most prominent being the institutions of economic order and of the judiciary (Luchterhandt 2007). In particular in some areas of the world such as in south eastern Europe or in the Caucasus or parts of Central Asia, some of the more prominent organizations of advisory services have been planting their flags. At times this was done deliberately in

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order to shut others out. And again in some instances the reasons for shutting other partners out might have to do with the arguments advanced by LOT.

This competition or the fight on the battleground is not an anomaly. In many cases, the battleground shows that institutions do follow different paths. And the incentives and structures that characterize the organizations are of course responsible for the way advice is spread, "how often, with what force, by whom and to whom" (Schauer 2000). LOT's arguments—taken on board by the Doing Business Survey of the World Bank—may have to be understood in this light.

This chapter will therefore not discuss the merits of the argument that legal origin matters. It will reflect on the principles that are shaping our approach to advisory services to strengthen the rule of law. It is based on the experience of long-term advisors in the field of legal cooperation.

17.2 Principles Guiding the GIZ Advisory Work on Legal Development

One of the outstanding advisors, Rolf Knieper, has summarized his experience. He had the good fortune to start his career as an advisor in legal development in Central Africa, which gave him a head start over those advisors that in the late 1990s worked in transformation countries; and later to round up his experience in the Far East. In an account that appears almost to be the "summa" of his advisory work, Knieper discussed, in a somewhat detached but still very much engaged manner many of the questions that are taken up in this chapter (Knieper 2006, 2010). Our current practice has benefitted from his experience.

This chapter starts with some perspectives of legal advice as part of the larger area of development cooperation. It then goes on to deal with some issues around topics related to the teachings of LOT. It ends with lessons we have drawn from this discussion or which have been confirmed in the course of the discussion.

17.2.1 Three Perspectives

For the GIZ, legal advice is part of development cooperation. Hence, the three following perspectives are important to understand our approach to legal origins:

- We never experienced a case where we had to build a system from scratch. We might encounter expressions of an interest to receive advice on a particular legal system. But this is an expression of policy sometimes prompted by a historical experience or an imagined history. So if legal origin matters, they do so only to the extent that they are absorbed by the system in place.
- The legal origins debate has helped us to rethink and refine our approaches. In particular, it was helpful to better understand implicit values and experiences

that influence our work and the necessity to be more transparent in dealing with these principles and values.
- Discussions focusing on legal origins underscore the precarious position of the so-called transplants—and again the importance of a locally defined equilibrium between global trends and systems, and local conditions as well as the ability to manage the difference.

17.2.2 The Playing Field for Rule of Law Advisory Services in Development Cooperation

The horizon of development cooperation is wider, yet different from the objectives of prosperity, wealth creation or straightforward growth that are usually formulated as outcomes of the creation of property rights. Our legal advisory work aims at the three overarching, related tasks of the German Development Cooperation, good governance, sustainable development and the reduction of poverty. To keep these in mind helps to structure advice, the reform context and the overall policies framework within which one has to situate the advisory relation. With these overall goals present it is useful to rethink the link between legal reform and development.

For new institutional economics there is a functional agenda presented very clearly by Richard Posner:

> A modernizing nation's economic prosperity requires at least a modest legal infrastructure centered on the protection of property and contract rights. The essential legal reform required to create that infrastructure may be the adoption of a system of relatively precise legal rules, as distinct from more open-ended standards or a heavy investment in upgrading the nation's judiciary (Posner 1998, p. 1).

This is a clear and unambiguous statement of the link between "relatively precise rules"—on other occasions one finds the recommendations for so called "bright line rules," i.e. rules that prescribe behavior with a kind of mathematical precision—and development. The benefits of having these rules are deemed even greater than the outcomes of an investment in upgrading the countries' judiciary.

A functional relation between the law and the way investors and regulators behave is certainly a given. But is it the only way to link legal development to development in general? And is the relationship "one dimensional" and "one directional"? The latter especially would be hard to believe since development in general must have some repercussions on the way legal development proceeds and the results it provides.

Sen (2000) has offered another way of seeing things. He started with the question of how law and development are connected. He came to the conclusion that there is a rather complex nexus between legal development and development. This might not be surprising since his idea of development is epitomized in the enhancement of people's capabilities—their freedom to exercise the rights and entitlements according to their abilities and wishes.

Legal development—to use that example first—is not just about what the law says and what the judicial system formally accepts and enforces. Legal development must, constitutively, take note of the enhancement of people's capabilities—their freedom—including their freedom to exercise the rights and entitlements that we associate with legal progress. Given this need for conceptual integrity (in this case, the need to see legal development not just in terms of legislation and laws but in terms of effective freedoms and capabilities), all the instruments that causally influence these freedoms must be taken into account in assessing what progress is being made in enhancing the development of a successful legal and judicial system.

17.2.3 Principles Based on General Governance and Development Issues

After having set out the development cooperation playing field let me start with some of the principles we cherish in our work. They have a bearing on the subject of legal development although they are based on general development cooperation advisory work.

17.2.3.1 It's the Process, Stupid . . .

Design (of legal reforms) certainly is an essential element of legal development—and therefore the origin of a legal system may be of importance because it should influence the design. But reforms are determined to an equal measure by the **process**: the process of starting reforms, sharpening the policy and program issues, developing possible designs, understanding the interests and the actors behind the reform, exploring the context of previous provisions and possible new ones, looking for alliances, empowering those that are affected or instrumental in making the reform a success, etc., has turned out to be decisive.

Many have been surprised by the traps and ambushes laid out against reforms or reformers. To the reformers who had their designs ready, most were totally unexpected, as Lopez de Silanes reports of Mexican judges that united against legal reforms (Lopez-de-Silanes Molina 2002). For outsiders, law appears to be a discipline of crystal clear and forthright solutions: you win or lose your case, you have rights or you don't have them, etc. So, to them, the reform track appears clear—you go from lawless situation to the rule of law, from the rule of discretionary power, to the rule of the civil or common law or from a program culture to a (human) rights based culture. Unfortunately, these are circumstances not found elsewhere in development. Reforms and policy making present a rather different picture, and even more so in developing countries. It has been succinctly outlined by Nordic development cooperation practitioners:

> Policy making in LDCs is primarily about mobilization and use of resources in a process characterized by conflicts and bargaining under conditions of constant change, resource scarcity, inadequate knowledge and insufficient capacity. (Therkildsen et al. 1999, p. 12).

17.2.3.2 Taking (Cross-Country) Analyses with a Pinch of Salt

The type of cross-country analysis used by authors of LOT in order to come to meaningful results makes a simplification of inputs and a selective interpretation of the results necessary. In other words they have looked for and presented a reality that cannot be found on the ground. Their initial assumptions and final conclusions seem to depend on too many short cuts: they interpret reality in a way that only allows for clear-cut answers. Their binary method of filtering the presence or absence of political, economic and legal conditions across a great number of countries produces an extremely selective and highly stylized picture of reality. This comes at the cost of losing many finer points or simply stopping further explorations. So, analysts and policy makers involved in legal reforms who are looking for facts—and reality is full of facts, get somewhat exasperated by such methodological shortcuts. Kenneth Dam in his study on the Judiciary and Economic Development compared several of LOT's findings with the more detailed reality he saw as a comparative lawyer:

> The title "Judicial Checks and Balances" leads off what purports to be an analysis of the distinction between French-style "separation of powers", which is concerned with preventing the judiciary from interfering with the sovereignty of the legislature, and US – style "checks and balances," which is concerned with allowing each of the three branches—executive, legislative and judicial—to check and balance the other two branches.
>
> Against that contextual background the legal origin authors find that common law systems do better than civil law in protecting "economic freedom" (though they find no significant difference in protecting "political freedom"). They proceed with their conventional analysis based on private law origins, despite the fact that Britain does not allow the judiciary to check and balance the legislature, which, as seen above, is in Britain considered sovereign, just as was traditionally the case in France. The authors proceed with their conventional analysis based on the origins of private law, despite the fact Britain, the original common law country, does not allow judicial review whereas many civil law systems, in Europe and Latin America, do indeed allow the judiciary to check and balance the legislature through judicial review. (Dam 2006 at p. 31)

What we are reminded of here is that many stories are told in order to make the case for legal system that fulfills the expectations of those looking for clear-cut and precise rules or contracts. These stories usually end with the conclusion that rights and contracts need to be enforced in their terms and written down in considerable detail, as if detail could be any insurance against the risk of unforeseen circumstances. Every so often Max Weber is called upon as a witness for associating the formalization of legal positions, which further development. Informal, oral, opaque and undifferentiated rules and institutions are supposed to hinder development. But then Max Weber himself drew the attention of his readers to the example of nineteenth century Britain that went through an extraordinary period of industrial

development although it had an opaque and, for outsiders, surely incomprehensible system of property rights for land and similar assets.

17.2.3.3 Do Not Rely on Extravagant Assumptions of Causal Development That Have Not Been Proven Historically

Development cooperation from the outset appears to be based on the idea that there is one clear concise and predictable way from the state of underdevelopment—as it has been understood in the Point Four Program of President Truman—to a state of development. Now, for President Truman that state was clear: it was a state where everybody enjoyed democracy, freedom etc., i.e. all those benefits the other side of the cold war bipolar system could not or did not want to deliver. For development cooperation this state may have originally been better presented in macroeconomic terms. But later the aims did change regularly and so did the intermediate milestones that would indicate that one was on the right track. And this works pretty well for the Millennium development goals, which are measurable. Every cent spent translates into progress towards these aims.

For social and political goals, determining the activities, the directions and the milestones to follow, appears to be somewhat more difficult. For many years now, legal development advisors have been trying to find indicators that are more appropriate to show that we are on the right track for the rule of law. We realize that it is exceedingly difficult to develop such a collection of indicators. And we suspect that indicators that satisfy the development cooperation community will be of little interest to our partners. But even if it would be feasible we are still a long way from establishing the intrinsic value of the rule of law for economic development. It will not only be difficult to design a road map between the rule of law and economic development, but we might even run into difficulties to establish the direction. We may find that we first need economic development before we can claim to make progress on the route to the rule of law.

For another example, consider the link between privatization and property rights. For the former communist countries in transition, the theory was put forward that the process establishing property rights could be expedited by the mass selloff of state enterprises to individuals: Karla Hoff and Joseph Stiglitz in their analysis of the emergence of the rule of law in post-communist societies found that several economists assumed that privatization would create a demand for institutions enforcing property rights and subsequently the rule of law (Hoff and Stiglitz 2004). They assumed that privatization offered an "enormous political benefit for the creation of institutions supporting private property because it creates the very private owners who then begin lobbying the government ... to create market-supporting institutions." The holders of property rights of privatized enterprises would constitute a powerful lobby for institutional reform, which in turn would lead to the emergence of the rule of law. This chain of reform steps was expected to lead to growth and the creation of wealth. And it would both confirm the institutions and the effectiveness of property rights.

As posited by Hoff and Stiglitz there was logic in this theory. But the expected chain of events did not take place. Factors not considered or anticipated derailed the process. And the policy-makers who set out to put the theory into practice, certainly did not take any precautions to manage the risks that could have and in fact did arise on the way. In sum, predictions for this kind of processes, with the countless actors involved, the uncertainty of the initial conditions, and the difficulties of getting reliable information, have a very low degree of validity. And building elaborate strategies based on these predictions turned out to be neither effective nor professionally sound.

17.2.3.4 Do Not Come to Law "in Flight from Political and Economic Complexities"

When foreign legal experts assess the legal needs of developing countries they almost always seem to assume that the problems they have identified can be resolved by the enactment of new legislations.

But do they really look for a just system or are they tempted to use legislation or laws as a substitute for sound policies? They use a law in order to stop discussions that may be cumbersome and politically risky. Particularly in the area of economic policy, solving problems by enacting laws seems prompted by a desire to limit discussion, to avoid dealing with the many consequences an economic policy may have, and the political risks that policy might entail:

> Unfortunately this new interest in law and development is often accompanied by an ambition to leach the politics from the development process and to muddle the economic analysis. They turn to law all too often in flight from economic analysis and political choice (Kennedy 2003).

It is tempting to consider law a benign instrument, compared to policies that are perceived as directly linked to power, to interests and resources. Legal design—and the idea that it expresses an objective state of affairs—likewise is assumed to be immediately applicable. The fact that laws are usually negotiated in Parliament and that the texts are usually an expression of compromise—and most often not the product of a gifted legal scholar—is often overlooked.

The same observation has been made by a Japanese colleague when he concluded that the legal origin proponents have encouraged the hope that choosing law (through some sort of abstract legal 'good' approach) can substitute for the perplexing political and economic choices that have been at the center of development policy-making for half a century (Yamada 2008, p. 15).

17.2.3.5 Be Aware of the Legitimacy Trap

German development cooperation advisors like most of their colleagues in the field of bilateral cooperation do not enter a country for an advisory assignment without

being called to do so by the partner country and without an agreement between this country and the Federal Republic. So, one could conclude that this process of bringing German law into the situation is useful and legitimate. But that would assume that the request is the expression of profound analysis and a coherent thoughtful decision—which cannot be taken for granted. In addition, the executive branch might have other ideas than the judicial arm of government.

Being called in to prepare legislation might even be considered to be a warning sign: foreign lawyers with foreign ideas may replace domestic lawyers that would not want to engage in such risky efforts to prepare a piece of domestic legislation, which may be politically inopportune and technically unfeasible. So finally, foreign legal experts may not only substitute for their domestic colleagues, they may also act as willing helpers of a government unable to persuade its own legal specialists of the soundness of the government's ideas (Stockmayer 1998).

On the other side of the equation, we find a curious attraction for foreign legal experts to come up with rules and legal provisions (Faundez 2000):

- Firstly, simply because legal drafting in an open environment is something that most lawyers enjoy doing,
- secondly, because by training lawyers are attached to closed systems of rules supposedly capable of resolving current and anticipating future problems,
- thirdly, because foreign legal experts often do not have the time or the resources to analyze and enquire as to how the legal systems of recipient countries work before deciding whether prevailing rules and practices are effective or whether new rules are called for.

Foreign legal experts come with the firm belief that law can do the job. They very rarely ask themselves why existing laws are deficient and even less why they were called in and who called them in (Bryde 1986). Often, they do not have much confidence in the legislative process. Like other experts they are convinced of the intrinsic value of the proposals they offer. Neither do they much believe that the proposals could be stopped by the legislature, not least because very few have had any substantial contact with their own legislature at home. So, an unholy alliance can result between local politicians serving their clientele and their foreign, well intentioned, but inexperienced, legal consultants.

17.3 Law and Institutions

17.3.1 Laws and (Weak) Institutions

In countries where the institutional and political systems are weak, legal reform, indeed any major reform, is difficult and at times almost impossible to achieve. In such countries it may be difficult to distinguish the process of law-making from the process of institution building in general: The rule of law cannot be secured where

institutional frameworks are so weak that the laws are simply not accepted. Additionally, if the rule of law is constantly questioned it may be much more difficult to establish a stable institutional framework. In fact, the rules of the game have to be honored by all.

LOT often mentions the institutional environment of property rights. However, there is little if any mention of how institutions need to operate in order to make property rights effective. They pay scant attention to the analysis of local institutions, their constraints and their opportunities.

Most of the countries we are active in have weak institutions, and institutional frameworks, be it because they are emerging from periods of strife and unrest, or because they are still in transition; institutions are often still part of the process of regaining stability and capacities. Those familiar with the literature on political development and in particular with World Bank publications on governance, know that this is, and has continued to be an important issue for advisors on the rule of law (i.e. Frischtak 1997). The seminal World Development Report on the "The State in a Changing World" has reminded us, that weak institutions are a problem that cannot easily be resolved and will not go away overnight (World Bank 1997, p. 151). Yet, it appears to be easy to ignore these warnings and the facts behind them. Indicators that tell us that weak institutional structures will have a negative impact on the outcome of reform processes, on policies and on laws resulting from these processes, are brushed away.

On the other hand, if a state and the old order have collapsed, would this situation not provide an opportunity to build a legal order from scratch, from a *tabula rasa*? The idea that a post-conflict or post-regime change situation is the right time to overcome old institutional constraints is a tempting one. But are we allowed to assume that we enter a vacuum, a situation where laws and the supporting institutional environment can be created effectively following foreign precepts? As Knieper has convincingly shown even in situations where advisors came in at a point in time when there was not only a regime-change but also a system-change, we are never allowed to assume that there is a blank slate or that we can ignore what one could consider the remnants of the old order. Even in the former republics of the defunct Soviet Union there was never a justification for starting out with a premise that one could develop laws and legislation without first analyzing the existing institutional context (Wälde and Gunderson 1994). The same is true for so called fragile states, especially for those states that have emerged from a conflict. In both cases, the analysis might be more difficult because people follow rules and patterns that may be informal but may have a stronger normative power than some of the institutions that had been imposed by the old system.

But then how can we speed up institutional development in order to support a new legal order? Are there any natural or constructed sequences between establishing institutions and making laws one has to follow? Or can we assume that laws and institutions follow the same change pattern? Does institutional development follow universally applicable patterns?

Again that would mean that institutions are a technical construct. But experience shows that any change of institutions responds to very different social and political

parameters. Institutions are like laws driven by their local environments. They are driven by efforts to find a balance between a legitimacy based on local priorities and a legitimacy derived from foreign models that often, because of their being new, appeared attractive. Still whether this mixture is appropriate in the end is decided according to local criteria. At some point in the process, new institutions may even use their newly gained power to influence these criteria. Nevertheless, the process is dominated by locally negotiated compromise and by local preferences. Effectiveness, in the sense of optimal goal attainment, plays a secondary role (Andrews 2009).

There are, of course, situations where powerful local actors welcomed foreign influences and in fact based their legitimacy on imitating foreign models of institutional design. They were initially accepted because the design was the opposite of the former order. Unfortunately, many of these changed institutions, not least because they did not correspond to the emergent local environment, had to be replaced at great cost. In times of abrupt changes, there is little time for a profound analysis of the problem. It is tempting to adopt foreign models that correspond to a quick technical fix, all the more so, if these designs come with financial or other assistance or incentives. In such cases, the foreign model may offer borrowed temporary legitimacy at best, but it will seldom remain a lasting legitimate solution.

From institutional development we have learned that there is no short cut for the initial phase of identifying basic problems to be addressed by legislation or institutions. Reproducing laws as a method or a tool of technical engineering might have some attraction, especially if it comes from an environment that is considered "advanced." But to anchor this design in internal preferences requires an extensive process of adaptation.

17.3.2 Law and Its Application and Enforcement

Why do firms that can make use of both contracts and courts, use formal contracts but shy away from court proceedings? We don't know but there is, at the very least, a time lag between the introduction of formal law and its use by the target group. Often it is the result of preferences for informal mechanisms of equivalent value—at least in the eye of those that are supposed to avail themselves of the formal procedures provided by law. This is most obvious in those cases where "modern" and customary law are competing and at times in conflict. These cases can be predicted with some precision. But it would be difficult to predict the preferences of the parties who have acquired information and trust during a long-term relationship and who are not eager to submit this relationship to the scrutiny of a third party not privy to this relationship or to public proceedings. Going to court might be a sign that these parties are not willing to invest trust and reconciliation, but rather risk jeopardizing the relationship (Steer and Sen 2008).

We have encountered many cases where foreign advisors provided legislation, which ran into problems because it could not be enforced. This is the case if courts are not staffed adequately or where paralegals have not been trained in enforcement procedures. It is also the case where enforcement does not command the same attention as a bill of substantive law and there is a presumption of enforcement until the first case has been decided and enforcement turns out to be impossible. This is particularly the case where new substantive legislation has been approved and enforcement procedures need to be extended to be applicable to the new substantive area. Firms acquire information and trust through long term relationships; social and business networks are significant reputation mechanisms. And often there is no guaranty that after the court's verdict the reputation is not lost and the network relations are not broken.

The nature and importance of informal mechanisms and their relations to modern legal institutions appear to have changed somewhat over the time. Social networks—though still by far the most important source of information—seem to have become somewhat less important where court decisions have become more predictable and where the parties can understand the way the court came to its verdict. But this might take a long time. And it may imply a change of behavior not only through policies and legislation but also through the courts or in the case of administrative law through the public administration. As has been observed in the case of Colombia, taxation theory, tax law, and tax administration may be severely out of step. The increasing importance accorded tax administration from the late 1980s was partly the result of the apparent failure of abstract tax theory, so much so, that tax administration reformers drew the conclusion that "in developing countries, tax administration is tax policy" (Casanegra de Jantscher 1991).

17.3.3 Laws, Institutions and Informality

Another source of influence that interferes with the reception of foreign laws and procedures can be the informal mechanisms of solving problems that are supposedly the realm of laws and their enforcement. In many areas, daily exchanges and transactions are not based on law but rather on custom. And custom may permeate even those areas of the economy that, because they are part of the formal sector, are subject to legal proceedings. In this way, one can observe contracts and contracting that are based on patterns and behavior reproducing patterns of the informal economy. The test comes when laws are passed, courts and jurisdictions established and judges trained only to realize that contracting parties are reluctant to use the instruments the law provides or to litigate in a court of law. The same happens in bankruptcy proceedings. All the preconditions are met but creditors do not file applications to the courts.

Informal patterns of transactions and their purposes play two roles: First, they can substitute for formal legal instruments fulfilling the same role. Commercial relations need not necessarily to be cast in contract form. Second, informal methods

and instruments are deemed more appropriate to create confidence and build trust between parties. Therefore newly created institutional forms of dealing with a conflict may remain underutilized.

If legal proceedings are seen as a way to reconcile the resolution of a case with the law, would parties submit to these proceedings, if the acceptance of law in general is rather marginal and has not stood the test of time, while informal ways of settling conflicts are still held in high esteem? Why should the parties subject themselves to third party judgments discarding traditional informal practices, if they are not sure that their competitors do the same?

These phenomena are not unknown even in developed countries with particularly high rates of litigation in formal courts like Germany (Chap. 5). Deakin and Wilkinson (2000, p. 146) report that while German firms are more likely to have formal contracts than English firms, they are also much less likely to take legal action against a supplier or buyer committing a breach of contract.

17.3.4 Minding the Gap

One reason why legal experts often appear to disregard the features of the local context—and therefore overestimate the effectiveness of law transfers—is because in their own jurisdictions they can take the context for granted. Where institutions are stable, where they have the capacity to adapt to change and where all parts of the legal system are interconnected; legal reform slips into the process of social and political change in a relatively unproblematic way. So, one can hope that the probability of gaps between social reality and formal laws is low. At whatever point one starts with a reform one can assume that the system will absorb the reform.

But what if the institutions are there; they bear all the familiar names but follow a different rational? What if reformers do not realize that the institutions perform differently—because even if resources and objectives are the same, procedures are different, incentives are nonexistent, human resources and other means are different etc.

This may be due to the fact that courts are not (yet) considered an effective and impartial enforcement mechanism. An additional reason may be that courts are not expected to be effective in complex transactions involving specific kinds of investments. One of the basic predictions in the transaction cost literature is that in the presence of specific kinds of investments, courts become less relevant because they have an ‘informational disadvantage’.

17.3.4.1 Law and Information

Contracts are bound to be incomplete and information about complex contracts and relationships may not be ‘verifiable’ (i.e. cannot be proven) in court. Courts cannot

judge whether a breach of contract has occurred if they have no way of verifying whether the circumstances that call for an action have actually occurred. Verifiability depends on the parties being willing to disclose information about their business activities. This may mean an about turn of past practice. Secondly, judges will still lack the experience to handle more complicated cases especially if they don't feel implicated with the parties and the economy but only to the law authorities.

17.3.4.2 Law as an asset

Law cannot be regarded as an endowment, a given, a right, that provides a firm foundation for market activities or on the basis of which one can build an institution or even a political strategy. Governance structures of all types, including law, must adapt and respond to changes in expectations from the social and economic actors. Relationship development is a highly iterative process. Law and institutions or law and markets are best described as enjoying a dynamic relationship, a relationship without clear one-way causal links but in fact more like intermittent links (Milhaupt and Pistor 2008). Moreover these causal links work in both directions. At its best, law is gift, an endowment—but it needs to be recreated permanently.

17.3.4.3 Some Extravagant Assumptions

It is rather tempting to disregard this type of bi-directional and evolutionary relationship between law and institutions at a time when the supposed stability and transparency of law are very much in demand to foster the functioning of markets or to provide a dependable framework for institutions. One would like to take a big modernizing leap ahead with the adoption of "relatively precise rules" that would do wonders for investment and could avoid the hassle of upgrading an independent judiciary. With an "initially modest investment for law reform" one could start a virtuous circle that would help economic growth, which in turn would generate more resources (Posner 1998). Of course, one would need *self-enforcing limits* to interference from "political officials" into the rule of law (Weingast 1997, p. 262).

17.3.5 Designing Laws and Building Other Institutions: Reform Overload?

Reforming substantive law and governance institutions at the same time: would that not result in reform overload? As the agenda of legal reform expands, not least because it is unfeasible to transfer laws and the constitutional settlements of another

legal order, a serious danger has to be acknowledged that the institutional framework of many states may deteriorate as a result of the large number of reforms that have to be processed over a relatively short period of time:

- An overcrowded reform agenda makes it difficult for officials in charge of the reform process to have the time to understand its wider implications.
- An overcrowded agenda also reduces the time for consultation and deliberation.

Hence, apart from weakening the institutional system, an overcrowded reform agenda may unintentionally also undermine the democratic process. Viewing reforms as interrelated and cutting across sectors may entail serious risks:

- First, by trying to address the root causes for bad legislation and finally of poor governance, one may over-load the reform agenda;
- Second, even the most committed reformers may shy away from undertaking a great number of comprehensive and simultaneous reforms.
- Third, overloading the reform agenda can undermine the credibility of genuinely reform-minded governments. The long gestation times for rule of law reforms may overstretch the confidence invested by citizens.
- Finally, who can guarantee minimum standards of knowledge and skill in varied areas in all simultaneous reforms—and who can resist the temptation to use short cuts or to make assumptions that are unrealistic? (Linn 2001)

17.4 Reform Processes Develop Over Time: And We Have to React to Them

- Considering complex institutional arrangements—and the different time frames their reforms require to be operational,
- Considering the necessity to invest in enforcement and implementation in order to meet expectations and to guarantee a minimum degree of coherence,
- Considering the need to investigate and account for informal arrangements including patterns of behavior and possibly also pre-existing rules and standards that have temporarily fallen into disuse,

there is no avoiding long-term context sensitive programs to promote the rule of law that are in line with on-going development activities.

In countries with relatively well-established programs and activity streams we can observe these changes—and we can design complementary programs for the rule of law. The following is a typified large-scale program that illustrates the nature and the sequence of steps for a program and our contributions to the process (Ahrens 2004, 2005, 2008; Falke 2010; Jahn 2007; Julius 2008; Reichenbecher 2010).

17.4.1 First Phase

- Preliminary approach to issues of law in relation to the envisaged reforms and to the body of rules governing specified areas of reform e.g. economic development.
- Consequently, the topic of initial discussions would not be the rule of law as such but rather the way that economic, social, and sometimes political reforms could best be framed and promoted, based on a general understanding of law and of the specific legal instruments of the reform area.
- General information on the reform area's law are required, including the concepts and application of the law (e.g. in the area of economic law, corporate law, competition law, law of capital markets, securities law, labor law etc.).
- There is a need for deeper and more focused discussions on specific reform topics, mostly related to the creation and strengthening of an organization implementing new legislation for example, a Competition Office, a Patent Authority, a Consumer Protection Bureau so that laws and regulations on patents and trademarks could be discussed with these emerging or already existing institutions so as to research, classify and solve problems of application of reformed laws.

17.4.2 Second Phase

- Broad based scanning of legislations, procedures, transactions or policy measures currently under discussion or consultation.
- Addressing the issue of Sustainability and Capacity Development

The focus of the second phase should be on methods and instruments to develop legislation and to apply law in a very general sense consistent with the principles of the rule of law. This must be done while keeping any change within the framework defined during the first phase and bearing in mind the interests and preferences expressed through overall economic and social policies.

The confidence built up during this phase usually leads to requests to examine further the legal implications in various areas that were hitherto the sole and exclusive domain of political decisions and programs. In the PR China we started with rules and regulations for the audit office and its activities, from there moved on to the budget and its structure. We concluded by studying the budget and expenditure processes of various institutions having varying affinities to the law and regulation, and in general to the rule of law.

As far as the topics covered are concerned, we found a typical series of topics that was on the menu of the authorities because of international agreements or global constraints; these included trade and trade related law, the principles enshrined in the global trade order and from there moved on to topics somewhat removed from the economy, but in need of rules, standards and models to ensure

some predictability. For example, the growing group of (semi) autonomous entities and state enterprises needed some guidance on their new activities given that a new structuring order for the sector had not materialized. One such area is administrative law, with its objective of safeguarding a system that citizens can trust, that is fair, and can be relied upon.

17.4.3 Third Phase

The third phase needs to bring home the efforts deployed during the two first phases. Here the program moves into a more general dialogue on the evolution of the rule of law. This is done by applying law in many different areas, considering the intrinsic value of law as well as its functional value for particular concerns of the state and the economy, or the rights and duties of citizens. This phase would focus on law as a means to defuse conflict and to institutionalize conflict resolution in court or out-of-court. Furthermore, this phase would deal with institutions and persons that could play a specific rule in implementing the law, conveying its aims or developing them further. This approach would center on locally defined functions or on special forms of economic exchange, such as land, water etc. The aim is to internalizes the principles of law, and bring into the purview of law those issues previously dealt with outside of its scope. What is more, there is a great likelihood that many questions postponed in the earlier phases will emerge. These questions include special enforcement regimes and modalities and their limits, or delegated rule-making power for autonomous entities within the bounds of a legal framework. This phase may also develop assessment criteria and parameters for the legal institutions, and refine some of the first phase solutions to improve coherence and homogeneity of the system and its decisions.

Unfortunately we have had no possibility to analyze, investigate and evaluate this procedure, that is, the interplay between the phases, the institutions and the degree of satisfaction that has been achieved. While the steps have been well documented, we have never been asked to compare our procedure with that of those using legal origin or transplants for legal reforms.

These steps and types of advice are based on a model developed for countries coming from a history where law has had a marginal importance. The sequence of steps for countries with a rule of law tradition, many people trained in law, and a well-defined judicial system, will differ from the above model, but the process, I submit, might well be similar. The same three step sequence, approximation, consolidation, and outreach/problem solving, appears advisable, since the objective is to develop the rule of law based on local contributions.

Based on our experience, we suggest leaving the legal origin issue aside and to emphasize providing development expertise and a subsequently broader discourse on the rule of law. Instead of looking for an optimal selection of legal instruments to be imported, we prefer to proceed in phases in constant interaction with the local

context and the global debate on how to create a sustainable rule of law, while taking advantage of the lessons to be derived from comparative law.

Of course, all this is rather new and the evidence we can call upon to support these ideas is not yet very robust. But as far as our experience goes, we believe that a context-based process and its inclusive nature offer the best guarantee for a rule of law that can withstand external shocks, internal disarray and a more general loss of direction. The type and degree of system change we can aspire to and the comprehensiveness of the phased approach has been most often been positively commented upon in external evaluations of our work and its perceived virtues.

17.5 Some Concluding Remarks

17.5.1 Context of the Law

For advisory work to have a more lasting success the analysis of the *context of the law* is paramount. There are many elements, all part of the context, which shape legal outcomes: from the politics of legal reform, to the culture of lawyers, from the institutional capacities, to the knowledge of how the law works and how to make law work.

The context has additional importance. Even when advice relates "only" to legal texts, only very rarely are we allowed to pass over the fact that the application of the law needs to be considered when drafting a text. Any new law first needs to be published and the text needs to be disseminated. But this is only a beginning. While the texts are of an overriding importance when it comes to spreading the law and its effectiveness, the way it is communicated and is made available to the legal profession and those who seek access to the courts will determine in large measure its acceptance and the acceptance of rule of law principles more generally. Written texts may make all the difference when applying a law, but so does a settled interpretation of the texts and effective judicial practice.

17.5.2 Challenge of State Building

The challenge of legal reform in many places is comparable to the *challenge of state building*—creating an order that is based on a negotiated process of rule making and institutions that are able to transform this abstract order into reality, a reality that is acceptable to its citizens and appropriate for how they relate to each other. But does that mean that in order to make civil law type legislation operational we have to import the entire constitutional set up from France or Spain to get things going? Or can we think of a process whereby the order is designed step by step with many errors and reversals but with the help of great variety of tried and tested ideas?

17.5.3 Sustainability

This is one of our essentials when defining successful conditions for the rule of law. This distributes the burden of promoting a functioning state and society on many different shoulders, including institutions, and empowering people to take up their respective responsibilities. Where does this leave the somewhat oversimplified notion that common law is decentralized and community oriented law, while civil law is centralist and statist; does this mean that the French revolution should never have happened, or that people-based legislation based on extensive consultation does not fit into a civil law system?

17.5.4 Informality, Gaps and Misleading Terms

The entrapments of the uninformed are manifolds. One famous German comparatist, Ernst Rabel, experienced this when working in foreign legal systems (Rabel 1951). Here, legislation often is less than effective. It suffers from a mismatch between the three powers: they are sometimes neither independent nor separate. Institutions bear names that have little or nothing to do with their capacities or to their actual activities. The situation is anything but transparent and the outputs are often unexpected, surprising and outright astonishing. Often there is no rhyme or reason to the outcomes, both positive and negative. In this jungle, can we assume that its "legal origins" would protect the design of legal transplant or of a legal reform? Or wouldn't it be affected by its new environment and gradually loose the links to its origin? It would be amazing if the supposed links to its origin could survive these situations.

17.5.5 Asymmetry

At the same time, advisors suffer from *the asymmetry* of what they want and expect to see, what they want to do and what the reality on the ground allows us to. Transposing a piece of legislation from one part of the globe to another is often a source of pride and joy for those involved in the process. They identify with the laws transferred, the institutions that developed them—and possibly with the legal order these laws come from. But, this begs the question whether or not the achievements of other legal systems may not be much more deserving of wider dissemination: well-balanced and equitable social and legal institutions, or a pluralist and, in principle, more comprehensive and inclusive order to name but two possibilities. Negative reactions sometimes pop up when civil law is likened to statist centralized law whereas common law is depicted as decentralized, closer to the people and similar nice sentiments. But it may be difficult at times to distinguish

the issue of the negative reaction from a political attitude. This is particularly the case for judges—especially in systems, where judges are recruited from among politicians or from among slates agreed between the major parliamentary forces (Santiso 2003, p. 122). While they may claim to be part of the independent judiciary, their demands are directed at other branches of government often leaning another way on the political spectrum.

17.5.6 History

Rule of law consultation has not had a long *history*. We were reminded by Thomas Carothers, "What we have been treating as a field is only just starting to become one after 20 years" (Carothers 2007). The reason for this "delay" is the complexity of law reforms. From a policy perspective, the key to remove various bottlenecks requires not merely a top down approach in the change of the legal system but a bottom up approach by the users of these legal systems to overcome the obstacles preventing a better access to law and justice. Over time the civil/common law distinction will lose its interest. Instead we will categorize laws according to their resilience, i.e. whether countries' legal systems can survive shocks and adversity by absorbing aspects of other legal systems.

17.5.7 Impact and Value for Money

What are the continuing challenges for promoting rule of law as part of international cooperation? One obvious, if somewhat conceptually difficult challenge, is the issue of *impact* and *value for money*. We have been reminded over and over that the results of our work are disappointing, mainly because we may have raised unfoundedly high expectations. Disillusion resulted although there were no other alternatives at hand. The rationale for pursuing rule of law objectives is not as robust as it once appeared. The short to medium term outlook is uncertain. In addition its impact is difficult to measure (see Docquier, Chap. 2). There is also a need to reach a deeper understanding of its effects in terms of problems solved rather than, as is usually the case, in terms of institutions established or strengthened.

17.6 Open Questions

If we stop here, a number of questions for the rule of law, the conditions of its emergence and its impact on the market economy, on development and on growth remain unanswered:

- Will the rule of law contribute to the reduction of social injustice, the empowerment of women and the active promotion of human rights, i.e. basic principles of good governance?
- Should the rule of law be a stepping-stone for a better acceptance of markets as a level playing field where participants have a fair chance to test their efforts?

These considerations open the way to more searching questions on the importance and impact of law and the expectations of those who are promoting it:

- Is a system of formal legal rules a necessary and sufficient condition for a working market-economy and a guarantee for economic growth?
- What will the impact of law be on the political process and organization, and in particular does it ensure favorable conditions for executing political programs and strategies within the rule of law?

Depending on the persuasiveness of the speaker, all these questions leveled at rule of law advisory programs could imply that law is a variable dependent on other areas, mostly of the economy and markets. While this may be true, we could as well formulate the contrary: Does law not influence the markets and can it not be said that a stable legal framework promotes economic development? So again, we cannot simply state that law evolves with the economy, as the contrary may also be true.

As far as the relationship between law and development is concerned, we need to consider law as an integral part of development. Amartya Sen claims that we cannot consider development separately from legal development. In his view, the overarching concept of development is a functional relationship that integrates distinct developmental concerns in economic, political, social, legal and other spheres. The integration is more than causal interdependence: it involves a constitutive connection to the concept of development as a whole. Legal development must take note of the enhancement of people's capacity—their freedom—*to exercise the rights and entitlements that we associate with legal progress*.

> To use the old analogy again, development seen as a whole - what we may call development tout court - is like a typical summer day, and it requires an integrated consideration of developments in distinct domains such as economic, legal, etc. (much in the way a typical summer day depends on the sun, the temperature, the blue sky, and so on). The claim here is not so much that, say, legal development causally influences 'development tout court, but rather that development as a whole cannot be considered separately from legal development. This is more than causal interdependence: it involves a constitutive connection in the concept of development as a whole. (Sen 2000, at p. 8)

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Part VI
Conclusion

Chapter 18
Institutional Convergence and Competition

Michèle Schmiegelow and Henrik Schmiegelow

18.1 Introduction

Evidence collected in this book from 64 countries of different levels of development or transformation confirms the comparative law theory of a convergence between common law and civil law. Court rulings drive the legal process in an increasing number of civil law countries (Chaps. 1, 4, 5, 7, 8 and 13), while statutes govern central economic fields including financial markets in the UK and the US (Dam 2006a; Chaps. 4–7). Reforms of the corporate laws of the UK and the US in the 1960s reflected the different economic structures of the two countries prevailing at that time, still predominantly industrial in the US, preponderantly financial in the UK (Baum 2001). Since France, Germany and Japan have adopted elements of one or the other, or both, there is no longer any common law/civil law divide (Chap. 1). While American insolvency and bankruptcy laws are recognized as more efficient than civil law patterns (Chaps. 1 and 15), corporate and securities laws tend to follow cycles of regulation and deregulation, more often than not remaining "behind the curve" of financial innovation (Chap. 4). Time-honored precedent in common law or general clauses of civil codes could overcome this dysfunction, if enforced by efficient civil procedure. Seminal court rulings helped markets adjust to Germany's hyperinflation in 1923 and to the oil crisis of the 1970s in the US. But the particular incentive structure of the cost and time inefficiency of lawyer dominated common law procedure, which has been evolving in the US has prevented most civil cases from ending in a trial and, hence, failed to offer such a solution in the Great Recession of 2008 and its aftermath (Chaps. 4 and 5).

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Post independence India kept its colonial transplant of codified British civil procedure (Chap. 7) and legislated a labor law more protective of workers in some ways than England, France or Germany (Chap. 6). Latin America's 20 former Spanish or Portuguese colonies coded by legal origins theory (LOT) as of French legal origin derived their pre-independence property and inheritance laws from Roman law and their post-independence codifications never espoused the revolutionary replacements of large properties of feudal times in the spirit of the inheritance rules of the *code Napoleon* (Berkowitz et al. 2003). Since the 1950s, many of these countries rather adopted English and American patterns of trust and estate in legislated form (Dam 2006b). This remarkable convergence may have had the regrettable side-effect of preserving the unequal distribution of land of the colonial period, which was singled out by the World Bank as one of the main reasons why Latin America did not achieve the same postwar economic miracle as East Asia (World Bank 2003). The most recent Latin American trend of convergence is a movement among legal scholars and judges towards applying the codes with greater liberty of interpretation than in the past (Chap. 8). Three Indochinese and five Central Asian countries base their legal transformation on new civil and commercial codes in the civil law pattern (Chaps. 9 and 10), while inviting mostly American advice in designing their economic laws (Black et al. 2000). China has been following a similar pattern of pragmatic choice in its dialogue with various Western partners on codified contract law, patent law, property rights law and registration of real estate transactions, while advancing the genre of legal commentaries in the interest of the dissemination of judge-made law (Chaps. 1, 3, 4, 13; Rehm and Julius 2009). The six countries affected by the Asian crises of 1997/1998 adjusted their insolvency and bankruptcy laws on American patterns, while Malaysia, the only common law country among them, strives to accelerating civil procedure by taking it out of attorney's hands and expecting judges to manage it in civil law style (Chap. 15). Seventeen African countries seek convergence through integration by the common Court of Arbitration of OHADA in Abidjan (Chap. 16). So do Latin American countries involved in legal reforms coordinated or assisted by regional institutions such as the *Centro de Estudios de Justicia de las Americas* (CEJA) or projects such as *Derecho Internacional Regional y Acceso a la Justicia en Latinoamérica* (DIRAjus) (Chap. 8).

Yet, institutional competition between the two legal traditions does continue as assumed by LOT. Ideally, institutional competition drives the process of convergence as countries interacting with each other through trade, investment and jurisprudential exchange take lessons from each other's legal process. LOT's assertion that common law is economically superior to civil law is infirmed, however, by reviews on both substantive and procedural levels. In corporate law, as LOT conceded in 2008, protection of shareholder rights is not better in Delaware than in Brussels, Frankfurt and Paris (Braendle 2005; Cools 2005). In contract law, the number of transaction cost reducing default rules in French, German, Japanese, South Korean, Swiss and Taiwanese codes is still higher than in American and English statutes even after several waves of civil law influence on codifying statutes in the UK and the US. The default rule advantage of the Western European and East

Asian civil law countries has compensated the financial center advantage of the UK and the US, as shown by dynamic panel analysis in 2010 with time series covering the legal and economic development between 1870 and 2008 (Chap. 3).

This default rule hypothesis was controlled for procedural efficiency in the same sample of eight developed and newly industrialized paradigm countries. Judge-managed civil procedure offers major functional advantages over lawyer dominated common law procedure as recognized by the most authoritative voices of American comparative law (Pound 1906; Kaplan et al. 1958; Frankel 1975; Langbein 1985) and of procedural reform in the UK (Lord Woolf 1996; Lord Jackson 2009), but ignored by LOT. The resulting procedural efficiency hypothesis (PEH) is that civil law procedure is less costly and time consuming than common law procedure. As a consequence, civil trials, once the defining source of judge-made law of English legal origin, are vanishing in common law countries, while contributing an increasing share of the legal process of civil law countries (Chap. 5).

The best substantive rules of contract, real estate, corporate, and other laws would remain dead letter as mere "law on the books" without being transformed into applied and practiced law by civil procedure. The cost and time efficiency of civil procedure just mentioned is a condition of access to justice just as essential as clearly codified or judge-made substantive rules. This is true for developing countries in Latin America (Chap. 8), Africa (Chap. 16), and South East Asia (Chap. 15) and transforming countries in Indochina (Chap. 9) and Central Asia (Chap. 10), just as for the middle income countries Brazil, Russia, India, China and South Africa (Chaps. 6, 7 and 13) and developed countries in East Asia, North America and Western Europe (Chaps. 4, 5, 11, 12 and 15).

Preferences of seekers of justice for alternative dispute resolution (ADR) in various countries can have different motives. Low litigation rates in Japan and the Netherlands have long been considered as results of cultural preferences for ADR. But recent social changes in the latter (Chap. 11) and an ambitious program of legal aid in the former (Chap. 12) have resulted in higher numbers of citizens going to court. In countries without clear cultural preferences for the maintenance of traditional patterns of informal justice, the prevalence of ADR is a strong indicator of cost and time inefficiency of formal civil procedure. In these cases, ADR functions as a palliative against unaffordable cost and delay in the court system (Chap. 5). Economically struggling developing and transforming countries of both English and French legal origin are well advised either to focus on reducing the occurrence of disputes by improved policies in areas of legal needs (Chap. 14) or to invest in the revival of traditional, or provision of new, fora of ADR (Chaps. 9 and 16).

Talcott Parson's sociological functionalism offers a simple matrix permitting to illustrate the interaction between polity, economy, culture and law involved in institutional convergence and competition between common law and civil law (Sect. 18.2). Descending from that very general, though laudably interdisciplinary, level of analysis preferred by LOT, we move to a more focused interaction between common law and civil law jurisprudence, which LOT largely ignores, and examine how various schools of legal and economic thought have interacted on the Parsonian matrix (Sect. 18.3). Finally, we apply Parsons' categories of goal

attainment, adaptation, pattern maintenance and integration to the types of social action required to meet the challenges that all actors involved in legal reforms in developed, developing and transforming countries invariably face (Sect. 18.4). Section 18.5 concludes with a call for putting theory in the service of practice rather than the reverse, in the American philosophy of pragmatism.

18.2 Interactions Between Law, Polity, Economy and Culture

While comparative lawyers have used functional analysis as a method of comparative law for a long time (Chap. 1), few of them would be inclined to enter the field of political theory, behavioral economics and religious sociology and take the use of econometric regressions of a conspicuously limited selection of indicators as a measure of the functional quality of common law or civil law seriously. Yet, there is growing awareness that the challenge of LOT needs to be met in the arena which they have chosen, i.e. a very basic sociological functionalism, quantified by indicators easily measured by econometric regressions and controlled by the logarithm of per capita GNP, or other variables of countries compared.

In order to connect with LOT's interdisciplinary attempt with its broad sociological references, Talcott Parsons' categories of sociological functionalism are an obvious choice as a matrix of orientation. Previously, we have found these categories most helpful in analyzing Japan's outstanding economic development from the 1960s to the 1980s (Schmiegelow and Schmiegelow 1989) as well as policies of assistance to legal reforms in transforming countries (Schmiegelow 2006). To be sure, Parsons' sociological functionalism is no substitute for rigorous political theory, economic analysis or jurisprudence. Parsons' self-confessed eclecticism is evident in his combining general equilibrium theory based on Pareto and Marshall utility with Max Weber's sociological explanation of culture, economy and society (Parsons 1968). But just that combination may help meeting LOT in its own arena. Of course, in the 1960s and 1970s, it became fashionable to regard Parsons' sociology as an outmoded conceptual collection. But for the present debate on the relationship between law and economics, they have a *prima facie* relevance. Parsons' categories constitute an elementary matrix of necessary components of any viable society and can serve as early warning against all too reductionist assumptions. Parsons proposes that any social system or action has four functional requirements, namely, goal attainment, adaptation, pattern maintenance and integration. In modern societies, these requirements are fulfilled by the political system ("polity"), the economy, culture and law (Parsons and Smelser 1956). In Figs. 18.1 and 18.2 these functions are represented by a simple matrix of four squares.

The four requirements of social action are dependent on each other. Each is both an independent and a dependent variable. This calls for caution against all too confident assumptions about a hierarchy of importance among the four. This

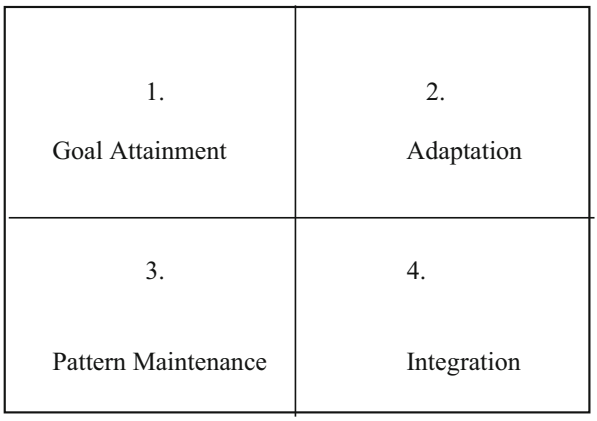

Fig. 18.1 Four functional requirements of a social system or social action. *Source*: Parsons and Smelser (1956)

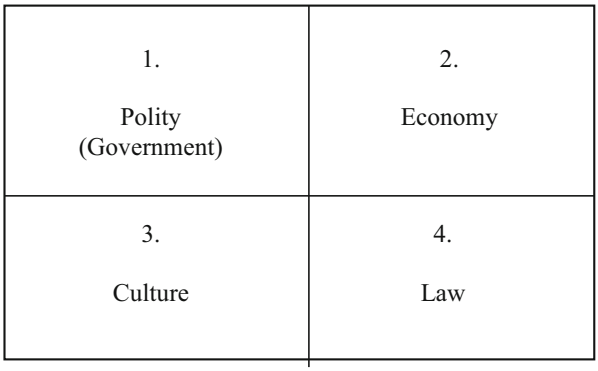

Fig. 18.2 Four functional requirements of a society (nation state). *Source*: Parsons and Smelser (1956)

caution is particularly important if the four requirements are elevated to the level of social subsystems of a society (Parsons and Smelser 1956). Figure 18.2 immediately makes plain how dogmatically or ideologically sensitive this elevation is.

The most widespread assumptions come into mind immediately: Anglo-Saxon nation-states emphasize 2 and 4 (free markets, strong rule of law), whereas continental European nation-states emphasize 1 and 4 (big government, strong regulations). LOT appears to share these assumptions while adding an intriguing emphasis on 3 as a factor explaining differences of 2 and 4, namely: Anglo-Saxon Protestant culture supports a strong economy based on a strong rule of law. Dissociative continental cultures correlate with big government, regulated markets and weak economies. It is easy to "color" the Parsonian squares accordingly, as in Figs. 18.3 and 18.4.

Of course, the evidence reviewed in Chaps. 1 and 3–5 of this book, especially the recurrent cycles of massive state intervention in both the UK and the US on the one hand and the fundamental economic liberalism of Roman contract and property law and the nineteenth century civil and commercial codes of France, Germany and Japan on the other cast doubt on bold assumptions on this level of generality

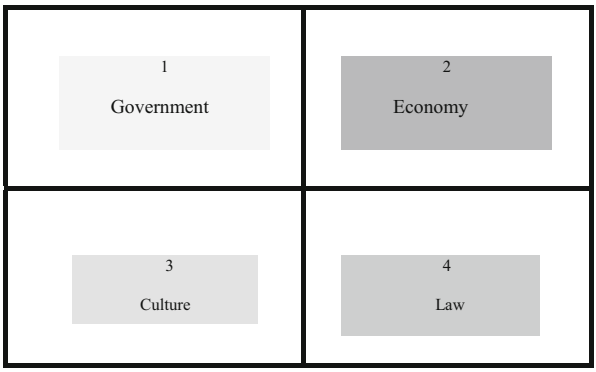

Fig. 18.3 Frequent assumptions about Anglo-Saxon economies and societies. *Source*: Schmiegelow M. (2009)

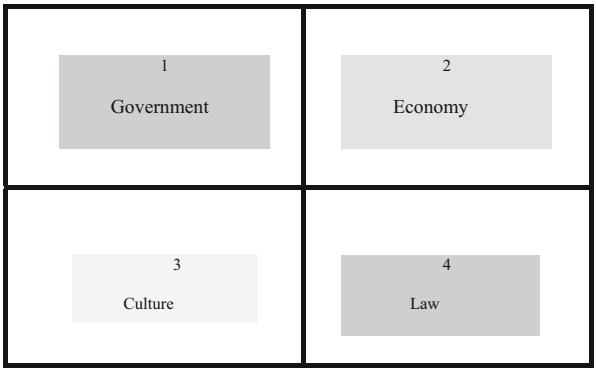

Fig. 18.4 Frequent assumptions about continental European economies and societies. *Source*: Schmiegelow M. (2009)

(Chap. 3). Ideological dissension on the supposed cleavage between Anglo-Saxon and Continental European patterns is "programmed", as it were, by prevailing clichés rather than by reality. Moreover, in its most recent and important restatement, LOT appears to have abandoned its reliance on Robert Putnam's sociology of Protestant trust in strangers for its thesis that common law encourages uninformed capital owners to trust corporate insiders that they will act in the best interest of their principals (Chap. 5).

However, the four functional requirements of Parsons' sociological functionalism can just as easily be broken down to more focused levels of legal systems and economies, as in Figs. 18.5 and 18.6. On these levels, agreement should be much easier to reach. Few will contest the unquestioned goal of any legal system, i.e. justice, as in square 1 of Fig. 18.5. Most legal scholars, except the remaining representatives of positivism, will concede that in the interest of justice, the law at times needs to adapt to economic and social developments. An economic crisis can be a catalyst of legal reforms, as five East and South East Asian countries have demonstrated in the Asian financial crisis of 1997 (Chap. 15). Most economists and the more practically minded lawyers will also agree that the law should serve to reduce transaction costs in the economy. Many sociologists of law and most actors involved in legal reforms in developing and transforming countries will subscribe

Fig. 18.5 Functional requirements of legal systems. *Source*: Schmiegelow H. (2006)

to cultural context as a functional requirement for the law (Chaps. 1, 5, 10, 14 and 17). And who will doubt that these three requirements should be integrated by a fourth, namely affordable access to the judiciary and a high standard of law abidance and law enforcement?

Figure 18.6 illustrates the division of labor taking place in the economic discipline between different schools of thought. The theory of economic policy focuses on the attainment of specific goals, such as keeping inflation in check, encouraging investment or engaging in reforms of the legal environment of markets (Tinbergen 1963). General equilibrium theories analyze how markets adapt autonomously to impulses such as price changes. Behavioral economics explains economic patterns beyond rational expectations, such as Max Weber's "Protestant" explanation of capitalism and, indeed, LOT (Chaps. 1, 3 and 5). Finally, Germany's postwar "ordo-liberalism" (Eucken 1950; Böhm 1966; von Hayek 1973) as well as new institutional economics (Coase 1988; North 1990) stress the importance of reliable legal frameworks helping markets to remain competitive and function at the lowest possible transaction costs. Occasionally, dogmatic dissension flares up between these schools of thought. This is to be expected whenever economic crises not predicted by mainstream economic theories, such as the subprime crisis of 2008, have the potential of triggering doctrinal reversals in economics. Exceptionally, the protagonists of dogmatic dissension in this case received a Nobel Price together: Eugene Fama for his efficient market hypothesis and Robert Shiller for his inefficient market hypothesis in 2013. While economics was clearly ahead of jurisprudence in adaptive response to the Great Depression and the subprime crisis (Chap. 4), legal responses paved the way of adjustment in Germany's hyperinflation of the early 1920s, in the oil crises of the 1970s and in the Asian crisis of the 1990 (Chap. 15). Clearly, economic crises and doctrinal dissension affect both sides of the emerging discipline of law and economics. And, inevitably, they affect developing and transforming as well as developed countries. The policy makers following such dissension should consider how Japan's strategic pragmatism cut across

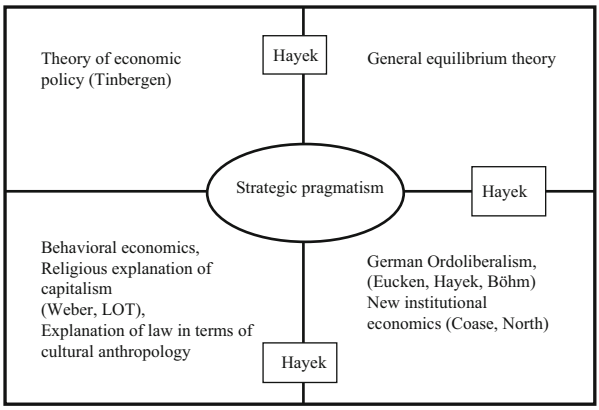

Fig. 18.6 Functional division of labor between economic theories. *Source*: Schmiegelow (2006)

contending doctrines and nurtured Japan's outstanding economic development from the 1950s to the 1980s (Schmiegelow and Schmiegelow 1989).

Figure 18.6 makes plain that, in spite of the many methodological problems of LOT, it cannot simply be discarded as a manifestation of the "neo-liberal" onslaught on Continental European legal and economic traditions. Their basis in behavioral economics (Square 3 in Fig. 18.6) was more solidly established by Shleifer and Vishny (1997) than appears beneath LOT's dazzling overreach of assumptions and the methodological problems of its econometrics. But the most serious challenges to LOT arise from methodologically solid institutional economics (Square 4 in Fig. 18.6) as shown in Chaps. 2, 3, 6 and 15.

18.3 Interaction of Common Law and Civil Law Jurisprudence

On jurisprudence, the common law and civil law traditions have been interacting intensively since the establishment of the Norman King's Court in Westminster (Chaps. 3–5). Their scholars have gone through all the agonies of doctrinal battles from the Natural Law concept of Thomas Aquinas, through nineteenth century positivism and twentieth century "interest analysis" and sociological jurisprudence.

Of course, as LOT stresses (La Porta et al. 2008), Napoléon insisted that judges should translate his codes as literally as possible into practical application and refrain from making law (Merryman 1996). At least since the 1930s, however, French judges have been filling gaps in the codes and finding the law by interpreting them in the light of evolving jurisprudence (Malaurie 1980; Chap. 4). Also, the design and language of the 1896 draft of the German civil code reflected Bernhardt Windtscheidt's conceptual jurisprudence (*Begriffsjurisprudenz*) and in the first years of its application tended to be applied with the inexorable mechanism of the positivist school reigning at the time. Scholars pleading today in favor of judge-

made law as a source of legal transformation tend to think in terms of the soft principle of "equity" in the early history of common law as an expression of natural justice and fairness in evaluating conflicting claims. Their perception of civil law codes often seems to be the one left by the initial positivist use of the codes more than a century ago. But, as we all know today, that positivist use misapplied the German civil code, since it neglected the principle of *Treu und Glauben* contained in § 242 *BGB* and today understood as an injunction to all participants in legal life to apply all laws, not only the civil code, *ex aequo et bono*, with "equity". Legal history mostly interprets § 242 *BGB* as a concession by the leading Romanist drafters of the code to Germanic traditions. But the Justinian codex already contained many of the most important principles that are now understood to be concretizations of § 242.

In the century since the entry into force of the *BGB*, all German codes have been subject to a vast array of amendments induced by a continuous stream, interrupted only by the 12 years of the Nazi regime, of court rulings interpreting the codes, filling their gaps or correcting their economic or social inadequacies or obsolescence in a process of "finding the law" (*richterliche Rechtsfindung*). This has been precisely the cognitive process that von Hayek (1973) and, before him, Fritz Kern in his celebrated article on *Kingship and Law in the Middle Ages* (1919), have so eloquently explained. Over time, after such court rulings became constant jurisdiction, legislation tended to integrate them into the codes.

The last major legislation of this type has been the 2002 reform of the second book of the *BGB*, on obligations, incorporating recent developments such as product liability as well as jurisdiction on *culpa in contrahendo* constantly recognized by the courts "beyond the code" since the early twentieth century. Chapter 4 reviews this process in the case of the migration of the Roman law principle of *rebus sic stantibus* through English, German and American court rulings to the 2002 reform of the *BGB*. In this way, German codes have continued to reflect both "old law" of the Roman or Germanic type grown in millennia and adjustments to contemporary functional requirements. A similar process is taking place in Japan, with the reform of the book of the civil code on obligations being the most recent project (Suizu 2011). The famous court cases of the Minamata disease in the 1970s have been a landmark of judge-made law forcing the hand of the Japanese Diet to enact reforms in the area of torts and environmental protection. Another example is the recent tendency of Supreme Court Judges to affirm the powers of the Supreme Court vis-à-vis the legislative branch by examining the constitutionality of existing laws, such as the decision of January 14, 2004 with a dissenting opinion of Justice Hiroshi Fukuda and the complementary opinion of Justice Tokyasu Fukuda on the rules for the election of the Upper House of the Diet (Saikinno Saikosai Kettei 2004).

Conversely, common law countries are no longer governed by judge-made law alone but also by an increasing array of written constitutions and statutes. While English common law remained the source of law in the North American colonies, legal development there has sharply diverged since their independence. Not only has the United States adopted a written constitution, but statutory law has played an

ever-increasing role since then. In the mid nineteenth century even English common law was codified for the purpose of transplanting it to other parts of the British Empire (Chaps. 3, 5, 7, 15). Most remarkably for the present discussion on judge-made law or codified law as sources of advice to transforming countries, Berkowitz et al. (2003) do recognize that this codification greatly accelerated the transplantation of the common law to India and other parts of the empire. Such an acceleration of legal transformation by using codified law as a pattern was precisely the reason for Karl Popper to recommend the German or French code to his Russian readers. Chapters 9 and 10 demonstrate just such an acceleration function of codification in the processes of legal transformation in Indochina and Central Asia.

Moreover, the German and the Japanese instant recoveries after the postwar currency reforms and price-liberalizations would not have been possible had households and enterprises been left to wait for judge-made law to grow for a few centuries, instead of using the instantly available legal instruments of their codes as well as the general clause of good faith, for their sales and purchases, works, services and leases energizing the economy (Schmiegelow 2006; Chap. 4). These instant recoveries may well serve as the quasi-natural experiments on which improved methodologies of measuring the effect of institutions on economic performance must rely (Chap. 2).

Also, English common law is no less "abstract" than the German or the Japanese civil law code. One of the greatest English judges in the eighteenth century, Lord Mansfield, famously stated as quoted by von Hayek (1973 at 121) that the common law was not constituted by particular cases, but by general principles, which are illustrated and explained by those cases. Nor have other English legal philosophers and judges been immune against constructivist or positivist tendencies. Hayek mentions Francis Bacon, Thomas Hobbes, Jeremy Bentham and John Austin in one breath with the German positivists Paul Laband and Hans Kelsen (1973, p. 107). And he is fully aware that common law precedents, if set and continuously followed by positivist judges or judges belonging to a particular interest group may end up constructing a "one-way street". As the most "paleo-liberal" representative of "ordo-liberalism", and with the experience of Nazi Germany's statism still a target of his writing, Hayek had a basic preference for the gradual process of judge-made law. But writing his *Law*, *Legislation and Liberty*, he did concede that such one-way streets of common law needed to be corrected by legislation (1973, at 124).

Hence, we may conclude this section with two propositions:

1. With positivism fortunately behind us, the cognitive role of the courts in England, France, Germany, Japan and the US is functionally equivalent however used we may be to the notion, rejected by Hayek as mistaken (von Hayek 1973 at 117) of a fundamental ethical or cognitive difference between common law and codified law in the Roman law tradition.
2. The relationship between judge-made law and legislation is a two-way street. They complement each other and correct each other both in common law

1. Enlightened judges "finding" the law in a cognitive process guided by equity	2. Claimants socially or economically aggrieved by existing laws or precedents
3. Defendants asserting the sanctity of existing laws or precedents	4. Legislators amending codes in line with new court rulings or judges considering new court rulings as precedents

Fig. 18.7 The functional equivalence of actors involved in the legal process of common law and civil law countries. *Source*: Schmiegelow H. (2006)

countries such as the UK and the US and in civil code countries such as France, Germany and Japan.

The functional equivalence of judges and legislators is easily illustrated by Parsons' matrix in Fig. 18.7 on the actors moving the legal process and Fig. 18.8 on the sources of law available to them.

18.4 Actors Involved in Legal Reforms in Developing and Transforming Countries

Whatever the functional advantages of common law or civil codes as sources for legal transformation advice may be, civil codes have the one advantage of their instant availability as a source and as a legislative technique. Just as Karl Popper has emphasized, that does not mean that foreign codes should be adopted wholesale as the final law of the land. The right balance between adaptation and pattern maintenance, contemporary legal needs and cultural traditions will have to be found by the sovereign legislators and judges of the transforming countries themselves (Chaps. 5, 7–11, 14 and 17). Figure 18.9 illustrates the actors, Fig. 18.10 the sources of legal transformation assisted by advice from common law or civil law countries in the matrix of sociological functionalism.

One aspect to which both foreign advisors and legal reformers in the developing and transforming countries will have to pay particular attention to is legal transaction costs. As demonstrated by institutional economics and evidenced by Japan's and West Germany's postwar recovery, good laws lower transaction costs and thus improve economic performance. As argued by Gilson (1984), good lawyers are, or should be, "transaction cost engineers" in Western legal systems. So are, or should be, *ordoliberal* legislators. However, one of the most important parts of a legal system influencing both the access to law and the demand for law, are the rules on legal costs, both court costs and lawyers' fees. If allowed to rise too high, such legal transaction costs may cancel out too great a part of the reduction of economic transaction costs produced by good laws. Theoretically, legal costs of judge-made

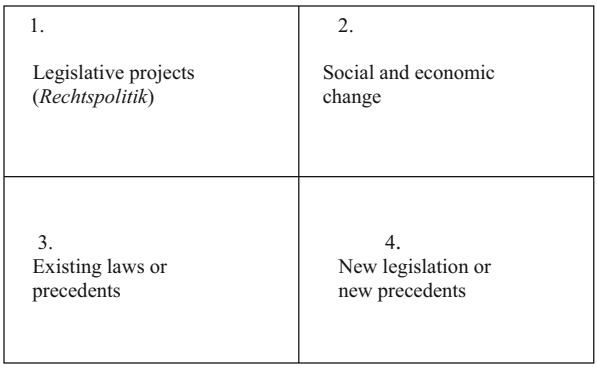

Fig. 18.8 Functional sources of the legal process of common law and civil law countries. *Source*: Schmiegelow H. (2006)

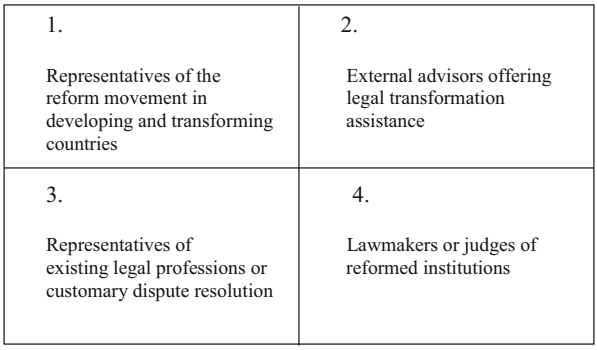

Fig. 18.9 Functional cooperation of actors involved in the transformation process. *Source*: Schmiegelow H. (2006)

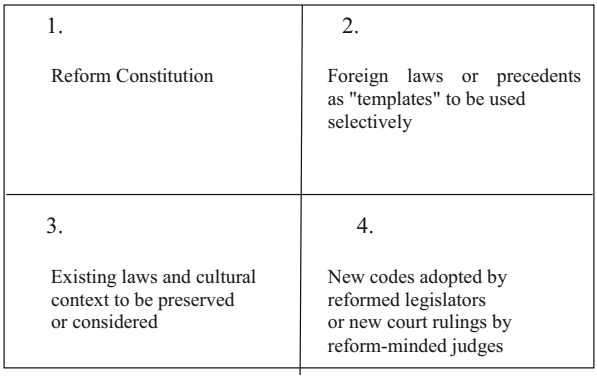

Fig. 18.10 Functional sources of transformed laws. *Source*: Schmiegelow H. (2006)

law and codified law should be identical for the law-seeking economic agent. Evidence from the "legal business" that sprang up around Westminster in medieval England (Danziger and Gillingham 2003) and from take-over practices of British and American law firms of Wall Street or of the City of London resulting, in the end, in higher fees for clients (Gupta 2004) has long been a mere suggestion that

legal costs in common law countries tend to be higher (Schmiegelow 2006). Evidence collected in Chap. 5 has now confirmed that suggestion.

One advice to reformers in developing and transforming countries would be to emulate the rule on cost and fee allocation prevailing in countries of German legal origin as well as in the UK. This rule shifts all court costs as well as both its own and the winning party's lawyers' costs to the loosing party. It makes justice much more accessible for parties with meritorious cases than in the large majority of other countries where each party to a dispute has to cover the fees of its own lawyer irrespective of the outcome of the dispute (Chap. 5). In this way, a small or medium firm newly founded in a transforming country has a fair chance to ask a top law firm to sue a global behemoth, to win the case and, on top, keep its sometimes over-borrowed balance sheet unaffected by the litigation. The confidence of Germany's SME's to have that chance was certainly one of the many little secrets of the *Wirtschaftswunder* of 1948 and their "hidden championship" in global manufacturing since then (Simon 1996).

18.5 Conclusion

Rather than being tempted or frightened by the boldness of legal origins theory, countries embarking on legal reforms might wish to let themselves be guided by another American inspiration: the philosophy of pragmatism. It teaches us to put theory in the service of practice rather than the other way around. Charles Peirce, William James and John Dewey, the founders of American philosophical pragmatism, were aware of scientific uncertainty (White 1973) even before Karl Popper published his Logic of Scientific Discovery (*Logik der Forschung*) in 1935, which became today's universally accepted scientific epistemology. Pragmatism means eschewing dogmatism, realizing that all knowledge is temporary, that action may be required even under conditions of uncertainty and across the cleavages of dogmatic contention, and above all, that adjustment and correction is imperative as soon as failure is recognized. Germany's and Japan's economic success stories reported in Chap. 3 are stories of economic pragmatism in full awareness of what competing economic theories had to offer. In Germany's case of post-war recovery, it was a confluence of *ordo-liberal* conviction and pragmatic acceptance of structural advantages, such as the civil and commercial codes, a functioning banking system and a wealth of technological know-how. In Japan's case, pragmatism evolved, moreover, into a sustained strategy encompassing all competing economic theories in their changing balance of persuasive power over the following decades (Schmiegelow and Schmiegelow 1989). With these cases as a background, the risk of theoretical dominance in LOT's version of institutional competition appears particularly salient. This risk is evident in the legal communities of both common law and civil law. Fortunately, as surveyed in this book, there is a growing convergence between the two systems, as legislation increasingly corrects and complements the common law, and as court rulings have been correcting and

complementing codes of French, German and Japanese legal origins over the past century and are continuing to do so. This history of convergence offers a rich reservoir of experience for actors in existing systems of formal or alternative dispute resolution as well as participants in legal reforms to consider.

The last part of the book illustrates how philosophical pragmatism can inspire strategies of legal reforms relying on functional interaction with other sectors of the Parsoinan matrix. Policies furthering specific social goals and/or economic adjustment should help reducing the occurrence of legal disputes which seem to overtax the judicial systems of countries concerned, especially those affected by high levels of poverty (Chap. 14). Policy makers inspired by institutional economics may use economic crises as catalysts for legal reforms turning calamities into progress (Chap. 15). Regional integration of formal or alternative dispute resolution of business law may not only promote convergence between common law and civil law, but also, eventually spill over into economic and political integration (Chap. 16). Rather than urging the templates of their countries of origin as "transplants", aid agencies and legal advisors should seek prolonged and phased discourse with the country seeking their assistance. Amartya Sen's insight that development as a whole cannot be considered separately from legal development should guide all parties to that discourse (Chap. 17).

The history of institutional convergence between common law and civil law is thus a history of social and economic interaction. Its lessons are open to all countries of the developed, developing and transforming worlds.

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