Common Law and Civil Law as Pro-Market Adaptations

Benito Arruñada*
Veneta Andonova**

ABSTRACT

We argue that in the development of the Western legal system, cognitive departures are the main determinant of the optimal degree of judicial rule-making. Judicial discretion, seen here as the main distinguishing feature between both legal systems, is introduced in civil law jurisdictions to protect, rather than to limit, freedom of contract against potential judicial backlash. Such protection was unnecessary in common law countries, where free-market relations enjoyed safer judicial ground mainly due to their relatively gradual evolution, their reliance on practitioners as judges, and the earlier development of institutional checks and balances that supported private property rights. In our framework, differences in costs and benefits associated with self-interest and lack of information require a cognitive failure to be active.

Key words: legal systems, judiciary, institutional development, behavior, enforcement.

JEL codes: K40, N40, O10.

---

* Department of Economics and Business, Universitat Pompeu Fabra. Mail: Ramon Trias Fargas, 25–27. 08005-Barcelona, Spain. E-mail: benito.arrunada@upf.edu.

** Department of Business, Universidad de los Andes. Mail: Carrera 1 No. 19-27, Edificio LA 204, Bogotá, Colombia. E-mail: vandonov@uniandes.edu.co.

The authors thank Jesús Alfaro Águila-Real, Douglas W. Allen, Marco Casari, John Drobak, Paul S. Edwards, Pierre Garrouste, Fernando Gómez-Pomar, Emily Kadens, Pierre-Cyrille Hautcoeur, Claire Hill, Marta Lorente, Thomas Lundmark, Bertrand du Marais, Armelle Mazé, Claude Ménard, Fernando P. Méndez González, Aldo Musacchio, John Nye, Elinor Ostrom, Celestino Pardo Núñez, Cándido Paz-Ares, Hans-Bernd Schaefer, Mary Shirley, Pablo Spiller, Stefan Voigt, Will Wilkinson, participants at several workshops and conferences for their comments and criticism, and Ann Bindu Thomas for her editorial assistance. This work has received financial support from the MCYT, an agency of the Spanish Government, through grant SEJ2005-03871/ECON, and the European Commission through the "Reflexive Governance" Integrated Project (CIT3-513420).

I. INTRODUCTION

Contrary to some naïve liberal perspectives, the proper functioning of a market economy requires that freedom of contract be protected effectively, a protection that can be achieved in different ways. A major design decision concerns the rule-making discretion that the principal, be it a sovereign or a parliament, delegates to the courts. When making this decision, the designer should take into account the specialization advantages and transaction costs that come with more or less specialized rule-making. Factors influencing this trade-off explain the different solutions adopted in the two main legal traditions of the West. The common law tradition evolved keeping more rule-making powers in the judiciary, and thus was characterized by unspecialized rule-making. The civil law tradition, on the contrary, was purposely transformed during the 19th century, reserving greater rule-making power to the legislative branch and thus reducing the discretion that judges had enjoyed during the Ancient Regime, discretion that was mostly retained in the common law.

By stressing this difference, some recent studies claim that common law legal systems provide superior solutions compared to those developed in the civil law tradition, in which judges have less rule-making powers.[1] This article criticizes these claims by developing and examining an alternative hypothesis, which states that both the common and the civil law have supported a transition to the market economy in adaptation to their circumstances. In particular, judicial discretion, seen here as the main distinguishing feature between both legal systems, is introduced in civil law jurisdictions to protect, rather than to limit, freedom of contract against potential judicial backlash. Such protection was unnecessary in common law countries, where free-market relations enjoyed safer judicial ground mainly due to their relatively gradual evolution, their reliance on practitioners as judges, and the earlier development of institutional checks and balances that supported private property rights.

From this adaptation perspective, we see a good part of the discussion on the efficiency of both legal traditions as focusing on relevant but relatively minor matters. This problem has been compounded in recent comparative studies by the difficulties of empirical comparisons in distinguishing causalities from correlations, and the fact that performances are observed only for choices that were effectively made, while the relevant comparison actually would be between the chosen option and its never observed alternative.[2] Such comparative analyses therefore provide

---

1. Compare, however, the historical study of business' organizational choices in France and in the United States during the era of industrialization. During the 19th century the contractual environment gave businesses in France a broader menu of organizational choices and greater ability to adapt the basic organizational forms to meet their needs. Naomi R. Lamoreaux & Jean-Laurent Rosenthal, *Legal Regime and Contractual Flexibility: A Comparison of Business's Organizational Choice*s *in France and the United States during the Era of Industrialization*, 7 AM. LAW & ECON. REV. 28 (2005).

2. *See* George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); Paul H. Rubin, *Judge-Made Law*, *in* 5 ENCYCLOPEDIA OF LAW AND ECONOMICS 543 (Boudewijn Bouckaert & Gerrit de Geest eds., 2000); Paul H. Rubin, *Why is Common Law Efficient?*, 6. J. LEGAL STUD. 51 (1977). *See also* Robert Cooter & Lewis Kornhauser, *Can Litigation Improve the Law Without the Help of Judges?*, 9 J. LEGAL STUD. 139 (1980); Avery Katz, *Judicial Decisionmaking and*

shaky grounds for policy recommendations. This may explain the recurrent paradox that, even though these empirical comparisons support the claim that the common law is superior to the civil law for the development of financial markets[3] and economic growth,[4] both transition and emerging economies opt for statutory law to create the legal basis of such markets. This choice follows the regulatory model of developed economies, which for many decades has been based on statutes.

Our discussion, therefore, broadens the argument by Rubin[5] that both common law and civil law facilitated freedom of contract and were efficient in the 19th century, and became interventionist in the 20th century as a result of common causes. Without claiming anything about efficiency, however, we explain why both common law and civil law solutions were well adapted to their particular circumstances, and point out the agency and cognitive roots of the changes experienced by both systems in the 20th century. This provides a novel perspective on normative issues in this area, suggesting that the value of legal systems depends not only on their specific traits, but also on a good environmental fit. Our aim here is to identify the local circumstances that defined the balance of the institutional trade-off and the forces that are shaping the current tendencies. Further work is needed, however, to develop and test the conjecture that the problem of transition and developing economies more closely resembles the challenge of creating market institutions in 19th century Europe rather than their remote evolutionary emergence in countries of common law.

The remainder of the Article is organized as follows. In Section II we analyze the specialization advantages and costs of the judiciary, and state our hypothesis concerning the cognitive roots of the structures and evolution of common and civil law. We argue that common law countries featured greater judicial discretion because, given their more gradual evolution away from the Ancient Regime, judges did not threaten the development of a modern market economy. Reformers in the civil law realm, in contrast, limited the discretion previously enjoyed by judges and put more rule-making in the hands of the legislature in an attempt to shelter free-market relations, and especially freedom of contract, from a potential judicial backlash. Both of these policies, promulgating codes and reducing judges' discretion, shared the same goal: that of protecting freedom of contract and promoting market relationships and economic prosperity in areas previously suffering from mandatory rules and judicial regulation of private contracts.

We then examine the consistency of our argument by reviewing the relevant historical evidence, in Section III, and the alternative explanations provided in recent comparative performance of legal systems, in Section IV. In particular, Section III analyzes the historical evidence on the evolution of both legal traditions, emphasizing the institutional details that contributed to their gradual divergence, which seemingly culminated at the end of the 19th and the beginning of the 20th centuries. We then compare, in Section IV, our argument with those produced in the recent debates about the comparative efficiency and performance of common and civil law. We contend that both theoretical and empirical claims on the superiority of the common law remain unproven. Legal systems do not operate in a vacuum; but rather, their

---

Litigation Expenditures, 8 INT'L REV. L. & ECON. 127 (1988); Peter Terrebonne, *A Strictly Evolutionary Model of Common Law,* 10 J. LEGAL STUD. 397 (1981).

3. *See, e.g.*, Rafael La Porta et al., *Law and Finance*, 112 J. POL. ECON. 1113, 1148 (1998).

4. Paul Mahoney, *The Common Law and Economic Growth: Hayek Might Be Right*, 30 J. LEGAL STUD. 503 (2001).

5. Paul H. Rubin, *Common Law and Statute Law*, 11 J. LEGAL STUD. 205 (1982).

performance depends on environmental conditions. Section V provides our conclusion, offering some opinions on viable policies, acknowledging the idea that legal systems must fit their environment, examining the policy implications, and emphasizing the importance of local circumstances for designing institutions.

II. THE CHOICE OF RULE-MAKING POWERS

Economic growth depends on market exchange, which requires a legal environment capable of increasing the capacity of parties to define wealth-enhancing terms of trade and to enforce them. Two key elements of this legal environment are rules and courts. Rules, given by customs, previous judicial decisions, and statutes, provide parties with default contract terms, and also predetermine the terms of trade to avoid externalities. Courts fill in the gaps in the contract and the received set of rules, defining the terms of exchange for unforeseen contingencies; provide enforcement of last-resort to contractual agreements; and, to a varying degree in different legal systems, create and modify rules.

A. The Tradeoff of Judicial Discretion

For our purposes, rules may be made by a central authority, such as a legislature or by courts. Courts' rule-making is more decentralized when each court has the freedom to decide the law for its jurisdiction. Conversely, judicial rule-making is more centralized when low level courts must decide according to jurisprudence exclusively produced by some higher court. Both of these dimensions of judicial discretion, the rule-making authority enjoyed by the judicial system or the legislature and the decentralization of judicial powers, are uncorrelated[6] or positively correlated, which allows us to treat judicial discretion as a single design variable. From this perspective, the main difference between legal systems hinges upon the degree of rule-making discretion enjoyed by courts.

The idealized model of the common law, as it finally emerged in the 19th century, is characterized by greater discretion for courts because statutory law plays a minor role and each court is relatively free to rule originally, even with respect to precedent. Common law, developed in England and later imposed on former British colonies, creates legal rules in a relatively decentralized and bottom-up manner. Initiatives for new rules start at the local level when a case is decided by a judge who creates a new rule, which remains local until other judges use it in their rulings. Successful rules may eventually become accepted by all courts in the state. Rules therefore result from the interaction between plaintiffs, defendants, lawyers, judges, and jurors, as courts are relatively free to decide each case by distinguishing from, reconciling with, or disapproving of an earlier case.

In contrast, the civil law model, as crystallized more or less at the same time, gives priority to legislative rule-making. Courts are instructed to enforce the received law, and lower level courts

6. *See* Daniel Klerman & Paul Mahoney, *Legal Origin?*, Univ. of S. Cal. Ctr. in Law, Econ. & Org., Research Paper No. C07-5 (2007), *available at* http://ssrn.com/abstract=968706 (arguing that the centralization of justice in the twelfth and thirteenth centuries was greater in France than in England while the decision-making authority of English and French judges was similar at the time).

have to comply with the jurisprudence created by higher courts even for filling gaps in rules and contracts. Civil law is more centralized, since the starting point for most new rules is legislation that applies to the whole state territory, and not only to the jurisdiction of one court. This legal tradition is based on Roman law, and is dominant in continental Europe, Japan, Turkey, and the former colonies of France, Italy, Portugal, and Spain. In civil law, judges are required to apply the rules, defined both by statutes and established case law (jurisprudence). Judges also fill in the gaps in contracts and rules in a manner similar to common law judges but with greater centralization, as explicit jurisprudence is only produced by repeated and consistent rulings of certain higher courts. This difference in the scope of rule-making capacity of the civil law judge is not substantially affected by the fact that even the ideal civil and common law models of the 19th century share many other features. For instance, in both paradigms, courts form a hierarchy and superior courts can overrule decisions from lower courts. Any case may have substantial room for interpretation, evidenced by the fact that the U.S. appellate courts defer broadly to the trial judge's and jury's findings of fact.[7] The presence of these common characteristics should not, however, obscure the existence of a basic difference in the extent of judges' rule-making discretion.

Additionally, common and civil law differ in other dimensions, such as the nature of the process, use of juries, and justification of judicial decisions.[8] In common law, litigation is led by parties' lawyers while judges remain neutral referees who only ensure that the parties follow the rules of procedure and evidence. The idea behind this adversarial process is that the truth will emerge in the dispute between the two sides. In civil law, however, judges take a more active, inquisitorial role and parties often have to answer judicial questions, on the basis that judges have a direct interest in revealing the truth in private disputes. Common and civil law also differ in their reliance on juries, with civil law making limited use of juries, a feature that ties in with the lesser discretion and the inquisitorial role of the judge. Finally, judge-made law in common law countries is justified by reliance on precedent, social norms, or rationality. Judicial rulings in civil law countries are based more on the meaning of the code, with case law and rationality playing secondary roles. This difference also affects the way that lawyers are trained. Common law is learned by analyzing case law, while civil law is taught by studying the code and commentaries on it.

All kinds of rule-making systems are likely to fail in achieving the public good because they pursue private interests or, even when pursuing the public good, they fail to ascertain which rules are more suitable to achieve it, often triggering rent seeking by parties to private contracts. We will argue that in the development of the Western legal system, cognitive departures are the main determinant of the optimal degree of judicial rule-making. In our framework, differences in costs and benefits associated with self-interest and lack of information require a cognitive failure to be active.

---

7. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 584–86 (5th ed. 1998).

8. *See, e.g.*, Richard E. Wagner, *Common Law, Statute Law, and Economic Efficiency*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 313 (Peter Newman ed., 1998).

1. Self-Interest

With self-interest, it is clear that legislatures suffer from agency and collective action problems, which can be palliated but not fully avoided by political competition and institutional checks and balances. Consequently, a large number of mandatory rules that today govern private contracting are alleged to neither improve individuals' rationality nor avoid externalities but simply to redistribute wealth.[9] Decentralized rule-making by the judiciary is similarly hindered, however, by the private interests of all participants in the litigation process, judges included,[10] who also show themselves as self-interested agents, sometimes in obvious ways that lead to corruption and congestion of courts.

We will assume that the rent-seeking costs of legislative rule-making do not change with the degree of judicial discretion. This assumption is mainly grounded in the fact that the legislature retains full powers, regardless of the degree of rule-making discretion granted to courts. Consequently, even when courts are initially given full discretion, the legislature can enact laws that end up constraining them. This is true historically, as the common law legislature always had enjoyed the authority to change common law rules, while even the highest courts were constrained by precedent.[11] One clear example is the final acceptance of the New Deal by the U.S. Supreme Court. We are certainly not arguing that legislation involves no transaction costs, but rather that these transaction costs were not the determining factor for the choice between the levels of judicial discretion characterizing the ideal common law and civil law models of the 19th century. These transaction costs could not be determinative because of variability in rent seeking potential across legal fields, and legislative residual power.

Similarly, the extent of judicial rent-seeking should not be substantially altered by the degree of rule-making discretion enjoyed by judges, who do not need to be producing rules to become corrupt or indolent. In addition, the fields of law (property, contract, torts) and the prevalence of default rules based on custom and established doctrine, which represent the bulk of legislation in the 19th century,[12] did not offer much potential for profitable rent-seeking at the legislative level. On the contrary, these fields may be more profitable for rent-seeking at the judicial level, by litigating specific contracts, but this only happens if the courts suffer cognitive biases that might be used by the parties. Therefore, it follows more of a cognitive rather than a self-interest rationale.

---

9. *See, e.g.*, Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 97 Q.J. ECON. 371 (1983); James Buchanan, *Rent Seeking and Profit Seeking*, *in* TOWARD A THEORY OF THE RENT-SEEKING SOCIETY 3 (James Buchanan et al. eds., 1980); Sam Peltzman, *Towards a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1979); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224 (1967).

10. For a description of the objective function of judges, see Jonathan R. Macey, *Judicial Preferences, Public Choice, and the Rules of Procedure*, 23 J. LEGAL STUD. 627 (1994).

11. Henry Manne, *The Judiciary and Free Markets*, 21 HARV. J.L. & PUB. POL'Y 11, 20 (1997).

12. Bruce L. Benson, *The Spontaneous Evolution of Commercial Law*, 55 S. ECON. J. 644 (1989).

2. Information

With respect to information, the allocation of rule-making power between legislators and courts also poses the typical problem of decentralization with respect to the availability and incentives to produce the relevant information and the costs of transferring information when decisions are not made where such information is available.[13] In our case, if a sufficient number of judges are available, decentralized judicial rule-making is usually thought to be more responsive to local and changing market circumstances because of its limited geographical scope, its proximity to market participants, and its relatively speedy process. In addition, in the presence of local courts with overlapping jurisdiction, decentralized rule-making is driven by competitive forces toward constant improvement.[14] In contrast, centralized rule-making and statutory law lack similar competitive pressures, especially in the short term (even if international mobility of resources is reducing this difference), but enjoy an advantage over decentralized rule-making in codifying default rules dispersed in custom, jurisprudence, and doctrine, as well as in developing standards for new kinds of contracts.[15] Centralized rule-making may also be superior in enacting mandatory rules that improve individuals' rationality and avoid negative externalities, which may not be dealt with in a decentralized process of rule emergence. A mandatory statute, in contrast, has the potential to force coordination, internalize network effects, and thus overcome the drive toward local, instead of global, efficiency characterizing decentralized rule-making.[16]

As in many decentralized decisions in all kinds of organizations, these opposing factors are hard to add up to a unique criterion. If anything, one could argue that the greater scope of

---

13. Masahiko Aoki, *Horizontal vs. Vertical Information Structure of the Firm*, 76 AM. ECON. REV. 971 (1986); Michael C. Jensen & William H. Meckling, *Specific and General Knowledge, and Organizational Structure*, 8 J. APPLIED CORP. FIN. 4 (1995); Raaj Kumar Sah & Joseph E. Stiglitz, *Committees, Hierarchies and Polyarchies*, 98 ECON. J. 451 (1988).

14. Todd Zywicki, *The Rise and Fall of Efficiency in the Common Law: A Supply-Side Analysis*, 97 NW. U. L. REV. 1551, 1575.

15. Compare this with Schwartz, who suggests that the role of the state should be minimal because the cost of creating rules is too high when parties are as heterogeneous as they are today and standards are too imprecise to be of much value. Moreover, information asymmetry hindering private contracting cannot be avoided by the state doing in law what the parties cannot do in contract. Alan Schwartz, *The Default Rule Paradigm and the Limits of Contract Law*, 3 S. CAL. INTERDISC. L.J. 389 (1994); Alan Schwartz, *Incomplete Contracts*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND LAW 277 (Peter Newman ed., 1998). This may also explain experimental results such as those described by Korobkin. Russell B. Korobkin, *Behavioral Economics, Contract Formation, and Contract Law*, *in* BEHAVIORAL LAW AND ECONOMICS 116 (Cass Sunstein ed., 2000). Schwartz's view deals with serious limitations of law-making but probably underestimates the private and social costs of contracting in the absence of default rules and standards, as well as minimizing the role of rules in reducing the impact of information asymmetry. *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989); Charles J. Goetz & Robert Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261 (1985). *See also* James J. Choi, *Optimal Defaults*, 93 AM. ECON. REV. 180 (2003) (providing a brief account and references on the power of default options).

16. Sophie Harnay, *Was Napoleon a Benevolent Dictator? An Economic Justification for Codification*, 14 EUR. J.L. & ECON. 237 (2002).

markets after the industrial revolution, especially after the advent of transportation technologies, called for more centralized solutions. We are also inclined, however, to discard the availability and production of information as a decisive factor in explaining the observed differences in the rule-making power allocated to courts by the common and civil law.[17] The reason is that larger markets may call for greater coordination of rules, but this can be achieved by strengthening the binding character of precedents, as the common law did during the 19th century.

3. Biased Rationality

Cognitive differences may have played a bigger role than both self-interest and information. Following the growing literature on decision biases and heuristics,[18] much attention in this field has been paid to the biases that judges may suffer when deciding cases. Guthrie, Rachlinski, and Wistrich show empirically, by means of a questionnaire answered by 167 federal judges in the United States, that these judges fail mainly by relying on irrelevant starting points to construct inferences ("anchoring effect"), by overestimating both the ex ante predictability of events after they occur ("hindsight bias") and in their own ability to reach correct decisions ("overconfidence").[19] Judges also treated equivalent gains and losses differently (falling prey of "framing effects") and ignored relevant background statistical information in favor of irrelevant individuating information (a conduct known as "representativeness bias").[20] Experimental results are difficult to interpret conclusively, however. For instance, in their seemingly biased responses judges may well be considering the allegedly irrelevant cue provided by experimenters (such as a defendants' move for dismissal when testing for anchoring effects) in the context of their previous court experiences, which could deny the alleged irrelevance of such a move.[21]

The most interesting of these biases is related to hindsight, that is, the tendency to attach greater probabilities to those events that have occurred than to those that have not.[22] Its presence

---

17. Compare this with Glaeser and Shleifer who argue that the adoption of the jury system in England and of the Romano-canonical trial procedure in France in the twelfth and thirteenth centuries determined the divergence between the two countries' legal systems. Edward L. Glaeser & Andrei Shleifer, *Legal Origins*, 117 Q.J. ECON. 1193 (2002). Klerman and Mahoney argue that the adoption of different trial procedures was dictated by the need for high-quality information given that the number of justices in England and France differed dramatically during the period. Klerman & Mahoney, *supra* note 6.

18. *See generally* THOMAS GILOVICH ET AL., HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT (2002); CHOICES, VALUES AND FRAMES (Daniel Kahneman & Amos Tversky eds., 2000); BEHAVIORAL LAW AND ECONOMICS, *supra* note 15; Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000); Vernon L. Smith, *Constructivist and Ecological Rationality in Economics*, 93 AM. ECON. REV. 465 (2003).

19. Chris Guthrie et al., *Inside the Judicial Mind*, 86 CORNELL L. REV. 777 (2001).

20. *Id*.

21. *Id*.

22. Evidence on hindsight bias, a phenomenon first described by Fischhoff, has been accumulating over time. Baruch Fischhoff, *Hindsight ≠ Foresight: The Effect of Outcome Knowledge on Judgment Under Uncertainty*, 1 J. EXPERIMENTAL PSYCHOL.: HUM. PERCEPTION & PERFORMANCE 288 (1975); *cf.* Jay J. Christensen-Szalanski & Cynthia F. Willham, *The Hindsight Bias: A Meta-Analysis*, 48 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 147 (1991).

in the legal system and the strategies used to handle it have been studied mainly in the narrow context of negligence judgments,[23] but hindsight bias may have much wider effects when the legal system allows judges to consider the balance of compensation between the parties, as it did in the Ancient Regime under the influence of canon law. In that case, judges will tend to give too much weight to *ex post* apparent imbalances without taking into account that such imbalances are often only the result of random events which could have led to different outcomes in which the net balance of compensation would have been different. Consequently, the bias motivates parties to devote resources both to using the bias in their benefit and to preventing it, so that contracts were often structured in order to avoid this type of opportunism. The presence of hindsight bias may therefore support a policy constraining the freedom of judges to evaluate the balance of compensation between the parties.

Most of these decision failures may be contained by reducing judicial discretion. For example, Rachlinski explains the set of constraints used by the legal system to reduce the effect of the hindsight bias in courts' decisions.[24] These constraints include taking compliance with norms as evidence of reasonable care in negligence cases; using secondary evidence of non-obviousness in patent cases; requiring more evidence than injury as proof of negligence; suppressing evidence on subsequent adoption of remedial measures, which would exacerbate the hindsight bias; and adopting a "no liability" rule for certain situations, like the business judgment rule in corporate law.[25]

These biases, however, cannot explain the different path followed by common and civil law, because both judiciaries suffer these biases to a similar extent. If anything, greater reliance on popular juries would advise less discretion in the common law, the opposite to the historical pattern.

4. Ecological Rationality and the Unnaturalness of Markets

In addition, there are reasons to think that decision failures of this kind are arguably not the most important cognitive bias for the optimal allocation of rule-making power. In particular, courts may be systematically biased to consider an evolutionary, outdated concept of justice. Taking this into account, a more comprehensive explanation of both types of failures can be given in terms of "ecological" rationality, which is bounded not so much because it is subject to constraints as because it is adapted to certain environments: first, to our common ancestral "environment of evolutionary adaptedness" and, second, with more malleable consequences, to our learning environment.[26] Therefore, even benevolent rulemakers may systematically rule

---

23. *See* Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 588–90 (1998).

24. *See id*. at 602–25.

25. For a broader analysis, see Guthrie et al., *supra* note 19, at 821–28.

26. *See* GERD GIGERENZER ET AL., SIMPLE HEURISTICS THAT MAKE US SMART (1999); Herbert Simon, *Rational Choice and the Structure of Environments*, 63 PSYCHOL. REV. 129 (1956); John Tooby & Leda Cosmides, *The Psychological Foundations of Culture*, *in* THE ADAPTED MIND: EVOLUTIONARY PSYCHOLOGY AND THE GENERATION OF CULTURE 19 (Jerome H. Barkow et al. eds., 1992). From this perspective, the importance of biases documented by experimental psychology and economics has been questioned because experiments may fail to face decision-makers with relevant situations, oversimplifying the informational structure of real problems. *See* GIGERENZER ET AL., *supra*; Leda

against efficiency because their instincts predispose them to solutions that were adaptive in our evolutionary past but are no longer adaptive in our current environment.

In particular, given that market relations are, in the evolutionary time scale, very new, they tend to be systematically misunderstood by poorly-cultured judges, leading to misguided justice. Findings in evolutionary psychology support the intriguing idea that these failures may respond to instinctive human traits being applied out of context.[27]

Judicial proclivity to redistributive justice and to balanced compensation fits in neatly with the prevalent role that sharing, authority, and reciprocity have arguably played in most human interaction during our ancestral "environment of evolutionary adaptation."[28] The apparent disregard that some judges show for the effect of their rulings on later trade seems also adapted to the ancestral environment in which trade was only made on the basis of reciprocity and most interactions took place among relatives and personal contacts. This probably causes a bias in favor of identifiable individuals and against anonymous parties,[29] a bias which is also likely to

---

Cosmides & John Tooby, *Are Humans Good Intuitive Statisticians After All? Rethinking Some Conclusions from the Literature on Judgment Under Uncertainty*, 58 COGNITION 1 (1996); Jonathan J. Koehler, *The Base Rate Fallacy Reconsidered: Descriptive Normative, and Methodological Challenges*, 19 BEHAV. & BRAIN SCI. 1 (1996). The usefulness of evolutionary psychology has also been criticized by Korobkin Rachlinski, and Ulen, the main concern being its inability to produce univocal predictions. *See* Russell B. Korobkin, *A Multi-Disciplinary Approach to Legal Scholarship: Economics, Behavioral Economics, and Evolutionary Psychology*, 41 JURIMETRICS J. 319, 323–27 (2001); Jeffrey J. Rachlinski, *Is Evolutionary Analysis of Law Science or Storytelling?*, 41 JURIMETRICS J. 365–70 (2001); Thomas S. Ulen, *Evolution, Human Behavior, and Law: A Response to Owen Jones's Dunwody Lecture*, 53 FLA. L. REV. 931, 938–40 (2001). For a defense of evolutionary psychology, see Owen D. Jones, *Evolutionary Analysis in Law: Some Objections Considered*, 67 BROOK. L. REV. 207 (2001), and, for a much-needed integrative view that defends combining rational choice and evolutionary psychology with empirical analysis in a multi-disciplinary enterprise, see Korobkin, *supra*.

27. *See* ALLAN PAGE FISKE, STRUCTURES OF SOCIAL LIFE: THE FOUR ELEMENTARY FORMS OF HUMAN RELATIONS (1991); Cosmides & Tooby, *Cognitive Adaptations*, *supra* note 26, at 163. These findings provide a common, and more solid, ground to the pioneering and rival arguments of Polanyi, on the limits of market-type relations and the resistance of societies to its dominance, and, mainly, Hayek, on the opposing rules of the "extended order of cooperation through markets" and the more intimate and personal order. The evolutionary argument helps explain both the difficulties for "disembedding" the economy, in Polanyi's terms, and the tendency to apply personnel rules to the market order, in Hayek's terms. *See generally* KARL POLANYI, THE GREAT TRANSFORMATION (1944); FRIEDRICH A. HAYEK, THE ROAD TO SERFDOM (1944); FRIEDRICH A. HAYEK, THE CONSTITUTION OF LIBERTY (1960); FRIEDRICH A. HAYEK, LAW, LEGISLATION, AND LIBERTY: A NEW STATEMENT OF THE LIBERAL PRINCIPLES OF JUSTICE AND POLITICAL ECONOMY (1976); FRIEDRICH A. HAYEK, THE FATAL CONCEIT: THE ERRORS OF SOCIALISM (1988). The danger that the primitive collectivistic leanings of human beings pose to the market has also been stressed by Smith from the perspective of experimental economics. *See* Smith, *supra* note 18. For an interpretation of the role of institutions as a solution for human maladaptation, see Benito Arruñada, *Human Nature and Institutions*, *in* NEW INSTITUTIONAL ECONOMICS: A GUIDEBOOK (Eric Brousseau & Jean-Michel Glachant eds.).

28. FISKE, *supra* note 27; Cosmides & Tooby, *supra* note 26.

29. The idea of favoring people we know is reinforced by findings that people faced with cooperation games cooperate more when they are allowed to communicate than when they play against anonymous parties. Robyn M. Dawes et al., *Behavior, Communication and Assumptions about Other People's Behavior in a Commons Dilemma Situation*, 35 J. PERSONALITY & SOC. PSYCHOL. 1 (1977); Mark R.

result in damaging judicial rulings. Such biases are more serious when an element of abstraction is present in the transaction because human minds, in contrast to their more intuitive understanding of concrete barter of physical goods, show intuitive resistance to grasping the value added by providers in abstract transactions. Mainly, these include those that involve intangible services and inter-temporal exchange, such as the use of capital and payment of interest; elusive services, such as mediation and arbitrage; and services provided by human capital that has been created through previous and therefore now invisible investments, like professional services. Not by chance, all of these abstract transactions historically have been among the first to be restricted or forbidden. More recently, the judicial apprehension against adhesion contracts can be traced to the same cause. The different treatment courts give to such contracts and to physical products, even though both are complex designs produced by competitive firms, can be attributed to this human tendency. As Manne pointed out, judges are willing to void a clause because the buyer does not understand it but they do not cease enforcing the purchase of a car because the buyer does not understand its engineering.[30]

This argument fits in well with some tendencies in judicial rulings. A common consequence of instinct are rulings, believed to be "fair" for an individual case, which favor the weaker party to a contract but, as a result, harm all weak parties to future contracts, who will end up paying higher prices or will be unable to contract. If, for example, a ruling in an insolvency case considers the debtor's poverty, it might resolve an individual problem, but, to the extent that it prevents creditors from collecting their debts, it hinders all loans that might be subject to similar rulings in the future. As a result, the ruling also harms anonymous potential debtors of a similar type to the beneficiary of the judgment, who are deprived of access to credit or will have to pay additional interest. In a similar vein, the substitution of the employment-at-will doctrine for unjust dismissal doctrines in several U.S. states has been found to have damaged new workers in those states, causing, among other consequences, significant increases in temporary workers.[31] The argument is also applicable to courts' bias against the exercise of quasi-judicial decision rights by the parties, even when the parties themselves have explicitly contracted for these quasi-judicial rights *ex ante*. Such an arrangement is often efficient when one of the parties has the best information and incentives to carry out such a judicial task because of its central position and

---

Isaac et al., *Public Goods Provision in an Experimental Environment*, 26 J. PUB. ECON. 51 (1985); Mark R. Isaac & James M. Walker, *Communication and Free Riding Behavior: The Voluntary Contribution Mechanism*, 26 ECON. INQUIRY 585 (1988); Kathleen Valley et al., *How Communication Improves Efficiency in Bargaining Games*, 38 GAMES & BEHAV. ECON. 127 (2002). This is the case even for one-shot interactions but especially as communication opportunities increase. Elinor Ostrom et al., *Covenants with and Without a Sword: Self-Governance Is Possible*, 86 AM POL. SCI. REV. 404 (1992). In addition to this bias, likely rooted in mental mechanisms evolved to facilitate cooperation, human beings have been shown to suffer substantial difficulties when making more than a few cycles of mental inferences in experimental settings, difficulties that could hinder the full evaluation of those rulings affecting market transactions, given that markets act through long series of overlapping effects. Colin F. Camerer et al., *Models of Thinking, Learning, and Teaching in Games*, 93 AM. ECON. REV. 192 (2003); Rosemarie Nagel, *Unraveling in Guessing Games: An Experimental Study*, 85 AM. ECON. REV. 1313 (1995).

30. Manne, *supra* note 11, at 34.

31. David Autor, *Outsourcing at Will: The Contribution of Unjust Dismissal Doctrine to the Growth of Employment Outsourcing*, 21 J. LAB. ECON. 1 (2003); Thomas J. Miles, *Common Law Exceptions to Employment at Will and U.S. Labor Markets*, 16 J.L. ECON. & ORG. 74 (2000).

reputation.[32] This quasi-judicial activity, crucial when controlling a network of producers, is undermined in court when judges interpret the subject matter of litigation as deriving from greater bargaining power on the part of the larger party and not from the *ex post* exercise of judicial functions that were contractually allocated *ex ante* by the parties. Such *ex post* contractual asymmetry tends to be perceived by judges in different countries as unfair and they therefore tend to correct it, thus inefficiently restricting the quasi-judicial powers, which the private contract itself allocates to one of the parties, and leading the parties to introduce additional contractual clauses with the purpose of avoiding judicial intervention.[33]

In sum, when insufficiently cultured about the market,[34] judges keep sentencing as if they were living in a non-market economy in which transactions are relatively unique, concrete, and reciprocal events, in which no credit element is involved.[35] Do legislators also suffer this anti-market bias to a similar extent? For some issues, such as those related to identification of individuals, it is clear they do not, because the legislature generally rules in more abstract terms and for anonymous parties, without respect to specific cases (at least in private law), while judges have a personal contact with the parties. However, this supposed advantage would affect all legal systems equally and cannot therefore explain the discrepancy in judicial discretion between the common and the civil law.

Furthermore, for most issues, legislatures are quite willing to follow redistributive policies, abrogating contracts if necessary, as has occurred often in history with debt contracts.[36] In general, the existence of a cognitive gap in favor of the legislature hinges on the structure of the political system. We maintain that legislators did not suffer a similar anti-market bias in

---

32. This explains why car manufacturers are assigned rights in relation to their dealers to define their obligations, assess their performance, and, as the case may be, punish or reward them. Benito Arruñada et al., *Contractual Allocation of Decision Rights and Incentives: The Case of Automobile Distribution*, 17 J.L. ECON. & ORG. 257 (2001). Many suppliers carry out similar quasi-judicial functions with respect to their retailers.

33. Scott E. Masten & Edward A. Snyder, *United States Versus United Shoe Machinery Corporation: On the Merits*, 36 J.L. & ECON. 33 (1993). Judges may also oppose the exercise of quasi-judicial functions by one party to protect its own power and thus eliminate competition.

34. Two remarks are in order. First, the "culturalization" that we are referring to is linked to an understanding of how the market works and has no necessary connection to the amount of formal training. Second, judges are influenced by cultural factors, such as education and religion, but these cultural influences always operate on a biological basis, which is constrained by the ancestral environment, the only evolutionary-relevant environment, as opposed to the current and historical environments. *See* THE ADAPTED MIND, *supra* note 26. For an introduction and updated references, *see also* STEVEN PINKER, HOW THE MIND WORKS (1997); Leda Cosmides & John Tooby, *Better than Rational: Evolutionary Psychology and the Invisible Hand*, 84 AM. ECON. REV. 327 (1994).

35. Our emphasis on judicial biases complements recent applications of evolutionary psychology to legal theory, most of which focus on how the law interacts with evolved minds, understand as legal actors such as citizens, holders of liability, contractual parties, or criminals. *See, e.g.*, Owen D. Jones, *Law and Biology: Toward an Integrated Model of Human Behavior*, 8 J. CONTEMP. LEGAL ISSUES 167 (1997); *see also* Owen D. Jones, *Evolutionary Analysis in Law: Some Objections Considered*, 67 BROOK. L. REV. 207, 209 (2001).

36. For example, consider the farm foreclosure moratorium enacted in the United States in the 1930s, upheld by the Supreme Court in 1934. Lee J. Alston, *Farm Foreclosure Moratorium Legislation: A Lesson from the Past*, 74 AM. ECON. REV. 445 (1984).

Continental Europe in the 19th century. As a result, a cognitive gap opened between legislators and judges, because the political system left the government in the hands of intellectual elites who had market experience and could also contemplate the profit opportunities brought about by economic change. The old Continental judiciary, however, was still staffed by a sort of nobility raised and anchored in the Ancient Regime. This is highly visible in the function of parliaments which, at the time, were considered the finders of the true and rational solution—the law. The intention was that the law should endure and be applied universally. In contrast, parliaments evolved in the 20th century as weighing machines or battlegrounds that reached equilibriums among private interests and produced mere "rules" according to the momentary will of the prevailing consensus, with no pretence of permanence and often in violation of freedom and equality as both concepts were previously understood.[37]

B. Hypothesis: The Pro-Market Orientation of the Western Legal System

The set of assumptions behind our cost and benefit analysis of judicial rule-making discretion, particularly the insignificance of self-interest, are equivalent to assuming a benevolent legislator who wants to create a market economy. This perspective is relevant for current discussions on how to develop market-supporting institutions in transitioning and developing economies. Historically, market institutions were created in a more spontaneous manner in common law societies. In civil law societies of the 19th century, however, they were subject to a greater degree of intervention by the builders of the liberal state, and therefore could be treated as decision variables. In analyzing civil law, we can then personalize these state builders who wanted to create a market economy, whereas in common law we have to assume a fictional social planner. However, the difference is not substantive.

Another assumption made is that predispositions toward the market order may develop differently among legislators and judges.[38] Consequently, this benevolent legislator will allocate rule-making discretion to the judiciary by considering the specific circumstances in each country. In particular, legislators creating market institutions may restrain judicial rule-making to avoid judges' opposition to freedom of contract and market exchange by compulsorily subjecting the judge to the law and thus guaranteeing the enforceability of private contracts. From this perspective, both Western legal systems might therefore be understood as adaptations to specific conditions that allow the development of effective market-supporting institutions in different historical circumstances.

In particular, modern market relations were introduced sooner in England, as many feudal constraints were abrogated earlier and the Industrial Revolution also took hold earlier. These changes also took place more slowly, without such drastic changes in property rights as on the Continent. This creeping evolutionary process, together with a generalized respect for private

---

37. This process was described, if not explained, by Schmitt. CARL SCHMITT, LEGALIDAD Y LEGITIMIDAD [LEGALITY AND LEGITIMACY] (1971) (Spain). It is now often seen as an exaggeration of democracy to the detriment of liberty. *See, e.g.*, FAREED ZAKARIA, THE FUTURE OF FREEDOM: ILLIBERAL DEMOCRACY AT HOME AND ABROAD (2003). In particular, see also how, in England before the Reform Act of 1832, law was something to be "deduced," not to be created. RICHARD PIPES, PROPERTY AND FREEDOM 127 (1999).

38. *See* Benito Arruñada & Veneta Andonova, *Market Institutions and Judicial Rule-making, in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 229 (Claude Menard & Mary Shirley eds., 2005).

property, gave time for judges and the public to be cultured in an intellectual tradition more propitious to the free market. In most of Continental Europe, however, most of the constraints that the Ancient Regime imposed on trade and movement of land and people were suppressed later and more abruptly,[39] often together with a redistribution of property. Most judges were then still the intellectual product of the Ancient Regime, in addition to part of the former ruling elite. Their lack of understanding of the market and disrespect for property rights explain why the defenders of contractual freedom, responsible for designing the institutions for continental markets, opted to constrain judicial discretion.[40] From this perspective, we explain the restrictions imposed on judges in the civil law tradition to subject their rulings to contractual terms (explicit or tacit through acceptance of default statute law and jurisprudence) as an institutional control designed to protect an unnatural creation, market contracting, from our ancestral collectivistic, reciprocal, and redistributional instincts.[41]

III. EXAMINING HISTORY

We will now examine in more detail the evolution of both legal traditions, to corroborate that the above arguments are consistent with their history. We first confirm that institutional checks and balances, and judicial training shaped the common tendency toward market-based relationships in England and in the Continent in very different ways. Second, we conceive the convergence of Western legal traditions during the 20th century as a restoration of instinctive social patterns, made possible by the democratization of the political system, which removed the cognitive advantage of parliaments and political leaders.

A. The Evolution of Common Law and its Judiciary

The commencement of what was to become the English common law system dates back to the 12th century, when Henry II (1154–89) created a professional royal judiciary and enlisted local communities to participate in the administration of justice. The further development of the English common law was shaped by the political struggle and the resulting balance between Crown and Parliament. The English Parliament was one of the few to survive from the Middle

39. The dominance of agriculture in the economies of these centuries should be kept in mind when considering that market relations for trade in goods had been well established in some areas of the Continent, probably better than in England, as shown by the history of Italian cities in the Middle Ages, the Hanseatic League or the Champagne fairs, to cite just a few examples. This applies, in particular, when ascertaining the importance of merchant law. The challenge for those creating the institutions of the modern market is to develop institutions not only for trade, but mainly for transactions among non-merchants.

40. It is possible that judicial discretion was, to a certain extent, already limited in the Roman law tradition from the 12th century, but this does not deny that later evolution additionally constrains judges' discretion and plays a market enhancing function.

41. Compare this with La Porta et al. who see the civil law as an attempt to further the power of the state. Rafael La Porta et al., *The Quality of Government,* 15 J.L. ECON. & ORG. 222 (1999).

Ages, constantly increasing its control over the Crown.[42] The result was a creeping shift of power from the Crown to the Parliament, eventually culminating in the Glorious Revolution, which further limited the Crown's right to tax and thus to interfere with private property rights, but was just only one more step in a relatively continuous process.[43] The English Parliament, staffed by merchants and landed gentry, then used its enhanced powers to ignite a series of market-oriented reforms based on the principle of non-interference with private property.[44]

The success of the reforms was guaranteed as the common law courts and the English judiciary shared the Parliament's appreciation of property rights and its understanding of market mechanisms. The appointment of English judgeships depended to a much greater extent than elsewhere in Europe on professional practice, as English judges were chosen from among barristers.[45] As such, they had seen the world from the perspective of the parties they had represented and were therefore more familiar and educated on the intricacies of the incipient market economy.[46] The understanding by English judges of the fundamentals of the market economy also benefited from the early checks imposed on royal authority, as these checks limited the ability of the Crown to sell new public offices,[47] making judgeships secure investments and converting early common law judges into defenders of private property rights. As a result, the transformation of the feudal economy spurred on by Parliament received an early ally in the English judiciary which, by making incremental changes in long-standing customs, assisted the evolutionary development of common law toward the new market order.

The expansion of market opportunities by the Industrial Revolution demanded more substantial changes in terms of both developed and uniform rules. Common law satisfied these demands during the 19th century, mainly through the introduction of many Roman law solutions and the strengthening of the doctrine of binding precedent, by which courts are reluctant to interfere with principles established in previous decisions (*stare decisis*). Despite these changes, however, the development of common law toward more market-oriented institutions remained evolutionary in nature and its courts retained a high degree of discretion, both in England and the

---

42. DOUGLASS C. NORTH & ROBERT P. THOMAS, THE RISE OF THE WESTERN WORLD: A NEW ECONOMIC HISTORY (1973); PIPES, *supra* note 37.

43. Douglass C. North & Barry R. Weingast, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England*, 49 J.L. & ECON. 803 (1989).

44. DOUGLASS C. NORTH, STRUCTURE & CHANGE IN ECONOMIC HISTORY (1981); North & Weingast, *supra* note 43. This view has been criticized by historians who point out that in spite of their absolutist nature, the Continent—particularly France—had well-developed markets as well. PHILIP T. HOFFMANN, GILLES POSTEL-VINAY & JEAN-LAURENT ROSENTHAL, PRICELESS MARKETS: THE POLITICAL ECONOMY OF CREDIT IN PARIS, 1660–1870 (2001). Even though researchers argue about the actual impact of the English Parliament on the development of a market-based economy, they do not question the deeper and earlier control exerted by it. STEPHEN R. EPSTEIN, THE RISE OF STATES AND MARKETS IN EUROPE, 1300–1750 (2000). Bruce G. Carruthers, *Politics, Popery, and Property: A Comment on North and Weingast*, 50 J. ECON. HIST. 693 (1990); Gregory Clark, *The Political Foundations of Modern Economic Growth: England, 1540–1800*, 26 J. INTERDISC. HIST. 563 (1996).

45. DANIEL DUMAN, THE JUDICIAL BENCH IN ENGLAND 1727–1875: THE RESHAPING OF A PROFESSIONAL ELITE 29 (1982).

46. KEITH ABBOTT & NORMAN PENDLEBURY, BUSINESS LAW (1933); DUMAN, *supra* note 45.

47. KOENDRAAD W. SWART, SALE OF OFFICES IN THE SEVENTEENTH CENTURY 45–67 (1980).

U.S.[48] This was for two reasons. First, the introduction of Roman law took place mainly at the level of concepts because codification attempts did not succeed, arguably because they were less necessary than in the Continent.[49] In addition, common law lawyers did not merely borrow ideas from Continental jurists, but developed and adapted such ideas in their own way.[50] Moreover, the legal development of common law, which supported the huge economic development of the 19th century, remained almost exclusively the work of courts, with few legislative initiatives.[51] Second, strengthening the doctrine of binding precedent did not divert common law from its evolutionary path, as precedents still could be overturned with relative ease by distinguishing the case at hand from the one in the precedent.[52] Together with the right of appeal, the doctrine was, however, important in ensuring consistency and equality across increasingly wider markets.[53]

American common law, to the extent that it was independent of English law, shows remarkable similarities. Until the 20th century, the U.S. had an arrangement similar to the English system of competing courts, with state and federal courts.[54] Court competition, however, was not so intense and judges were not paid on a fee basis.[55] Many judges, however, were elected and this probably served as a substitute incentive mechanism in the absence of a fee for service.[56] American common law judges also enjoyed great discretion that was marginally reduced in the 19th century by the adoption of the doctrine of binding precedent, first for procedural and later for substantive rules.[57]

---

48. *See* DANIEL KLERMAN & PAUL MAHONEY, *The Value of Judicial Independence: Evidence from 18th Century England*, 7 AMERICAN LAW AND ECONOMICS REVIEW 1 (2005) for the development of common law under English judges. For development of common law under U.S. judges, see Zywicki, *supra* note 14.

49. This divergence in the success of codification is consistent with the argument that continental codification was driven by the need to constraint judges, more than to systematize the law, which was probably equally unsystematic in England and on the Continent.

50. BRIAN SIMPSON, ENGLISH COMMON LAW, 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, 57–70 (Peter Newman ed., 1998).

51. This does not mean, however, that England did not need legislative interventions to make possible market enhancing institutions which were being hindered by a conservative judiciary. See, for example, on the recurrent failure of the English judiciary to accommodate the basic working principles of company law until forced by statute law, RON HARRIS, INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION 230–86, 1720–1844, (2000). As Harris says, "the turn to legislation was not unique to company law. The days of Mansfield and Blackstone were over, and the limited scale of reforms that could be achieved through common law became more evident as Bentham and the law reform movement of the early nineteenth century demonstrated. The province of legislation was being determined and Parliament became the target of reformers in criminal law, procedure, and other fields." *Id.* at 249.

52. The demand for more binding precedents during the 19th century is understandable because of the greater geographical scope of the market, triggered by better transportation technologies (channels, railroads, steamships), which required faster adoption of uniform legal standards in a wider area.

53. Manne, *supra* note 11, at 13–19.

54. Zywicki, *supra* note 14.

55. *Id*.

56. *Id*.

57. *Id*.

B. The Law in the Continent

Legal history in what are now civil law jurisdictions originally resembled English law. The evolution of civil law, however, was influenced by a relatively different balance of powers among the main political actors, as parliaments in Continental Europe, with a few exceptions, rapidly lost their ability to impose controls on the Crown.[58] Most monarchies became financially independent and a considerable part of their income no longer came from taxes needing previous parliamentary approval.[59] As a result, absolutist Continental kings enjoyed unchecked power and interfered with relative ease in private property rights, thus hampering the development of market relations based on secure private property.[60]

These institutional limitations were reinforced by the fact that Continental judges were appointed without previous practice.[61] In addition, their training was based on the university study of *ius commune*, a doctrinal system developed mainly by scholars proficient in Roman and Cannon law, and only secondarily affected by statutes and judicial rulemaking.[62] It has been claimed that both the lack of practice and these doctrinal influences made Continental judges more resistant to capitalist wealth accumulation and hindered their understanding of market transactions.[63] Market relationships, with their considerable risk of exposure and striving for profit, were hardly understood by a judiciary which derived most of its income and status from risk-free rents.[64] Judicial respect for property rights also probably suffered because judgeships were often expropriated by kings who were free to sell new judicial offices.[65] Thus, the judiciary on the Continent did not gradually erode the constraints of the Ancient Regime.

Because of both institutional constraints and judicial training, civil law judges ended up constituting a barrier to the development of new market relationships. Liberal reformers could not have chosen to maintain greater judicial rule-making authority while changing the method of judicial selection because jurists were educated in the same dogmatic legal tradition. An abrupt change in both the law and the administration of justice was therefore necessary.

C. The Creation of Modern Civil Law

The new legal order was mostly implemented in a top-down fashion even if it was essentially a liberal (that is, free-market-enhancing) initiative. Legislators issuing Civil and Commercial Codes in the 19th century aimed at regulating externalities and systematizing custom and case law mainly through default rules. They did not promulgate mandatory rules unless they were necessary to establish basic political and economic principles of freedom, equality, and property,

---

58. NORTH & THOMAS, *supra* note 42; PIPES, *supra* note 37.

59. *Id*.

60. *Id*.

61. WILLIAM DOYLE, VENALITY: THE SALE OF OFFICES IN EIGHTEENTH-CENTURY FRANCE (1996).

62. *Id*.

63. ARRUÑADA & ANDONOVA, *supra* note 38.

64. George Taylor, *Noncapitalist Wealth and the Origins of the French Revolution*, 72 AM. HIST. REV. 469 (1967).

65. DOYLE, *supra* note 61; SWART, *supra* note 47.

often debasing interventionist legal doctrines.[66] Their reliance on case law led to the codification of well tried default rules without precluding parties from adapting the contract freely to their circumstances by writing specific clauses into them. In addition, codification benefited from the substantial convergence of doctrinal criteria that was already highly influential in courts' rulings because of the prevalent regime of judicial personal liability. As a result, 19th century codified law was mainly the distillation of customary law, and codes represented a combination of local customs, local laws and subsidiary Roman law.[67]

In addition, most mandatory rules enacted at the time had a clear function in grounding the market economy. Probably the most important of these mandatory rules are a direct consequence of the political principles of freedom and equality, which have contractual correlates in terms of mandatory freedom of contract and mandatory equality of all contractual parties.[68] But it is also applicable to the emphasis of liberal reforms in avoiding the future entail of property and facilitating the emergence of a proper market for land.[69] Property law provides another interesting case in its treatment of externalities caused in the Ancient Regime by the proliferation of property rights and the enforcement as rights *in rem* even when they remained hidden to third parties. During the 19th century, land law reform and the creation of land registers led to a stricter policy of *numerus clausus* in most European countries, that is, the legal system started to enforce only a limited number of rights *in rem*, enforcing the rest as mere personal (i.e., contractual) rights. In parallel, publicity was increasingly required to produce rights enforceable *in rem*. While both of these constraints seem to diminish parties' freedom to produce rights *in rem*, in fact they are essential to make some of them possible by reducing transaction costs of acquiring land and making possible the use of land as collateral for credit, precisely the declared purpose of the reforms in this area.[70]

Furthermore, operationally, the civil law bound the judge to the law. This has often been seen only as a tool to enforce state law, although the main effect of default rules were to protect freedom of contract by making sure the judge was constrained by the will of the parties. Therefore, the law protected the private legal order freely created by the parties, whereas under a system of greater judicial discretion this private legal order would have been in danger.[71] This

---

66. R.C. VAN CAENEGEM, AN HISTORIAL INTRODUCTION TO PRIVATE LAW (D.E.L. Johnston trans., 2003).

67. Boudewijn Sirks, *Roman Law*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 356 (Peter Newman ed., 1998). In particular, codifiers of commercial law, from the Code Savary in 1673 to the Uniform Commercial Code of 1970, relied heavily on the *lex mercatoria*, developed by merchant courts. Bruce L. Benson, *Evolution of Commercial Law*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 88 (Peter Newman ed., 1998).

68. For example, previous law often granted higher probative status to the word of employers than to that of employees.

69. Notice that by the 17th century the common law had already developed the Rule Against Perpetuities, which enabled a court to declare void future or postponed interests in property that might vest outside a certain perpetuity period. The goal of this rule was to prevent land being tied up and encourage free markets.

70. Benito Arruñada, *Property Enforcement as Organized Consent*, 19 J.L. ECON. & ORG. 401, 403–06 (2003).

71. We ignore private legal order solutions, since we think they suffer intrinsic difficulties to become the legal order for a modern capitalist economy. The reasons for this are, first, because the reliance of

fear drove the efforts of 19th century legislators to purge many dogmatic rules from received law, often rooted in Canon law, that were contrary to freedom of contract.[72] A prominent example is the liberalization of credit transactions, which were still subject to substantial constraints, including the prohibition of interest and foreclosure.[73] Similarly, they often prohibited the judge from reducing the amount of penal clauses contractually established to punish the debtor for default in paying back a loan.[74] Most codes also derogated rules that had allowed courts to disregard some "unequal" contractual clauses on the basis of scholastic "just price" arguments, such as the doctrine of "lesion."[75] More importantly, the scope of "cause" as a necessary element of any enforceable contract was considerably reduced (by reversing the burden of proof, for instance), and even fully eliminated in the "abstract" transaction of the German Civil Code, as well as, more generally, in the laws of mortgages and bills of exchange.[76] This pruning of the concept of cause curtailed notably the possibilities of constraining

---

private enforcement on group membership limits its effectiveness to intra-industry trade, often with a personal character; second, because they are only effective when state judges abstain from acting as appellate courts and they always remain threatened by this possibility (otherwise, private enforcement is only based on informal social sanctions, increasing its personal character); and, third, because in most of Europe, private solutions were applied in relatively minor areas of the economy—mainly the merchant courts, where they seemingly ruled without appeal. Benson, *supra* note 12, at 650. *See also supra* note 39. For an in-depth discussion of the ignored private solutions, see generally ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992); Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Imminent Business Norms*, 144 U. PA. L. REV. 1765 (1996); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001); Avner Greif et al., *Coordination, Commitment and Enforcement: The Case of the Merchant Guild*, 102 J. POL. ECON. 745 (1994); Paul R. Milgrom et al., *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 ECON. & POL. 1 (1990); Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEGAL STUD. 1 (1995).

72. Until the eighteenth century, for example, French laws against usury had the effect of denying short-term credits that were indispensable for commerce, industry, and banking. Borrowers and debtors then had to spend substantial recourses to circumvent the prohibition, which hindered the development of the financial market. Taylor, *supra* note 64, at 480. Understandably, a main goal of the Napoleonic Code was to empower contractual parties to act on their own behalf, protecting them from anybody, including judges, who could alter the terms of their agreement. UGO MATTEI, COMPARATIVE LAW AND ECONOMICS 186–87 (1997).

73. *Id*.

74. Didier Danet, *Does the Civil Code Matter?*, 14 EUR. J.L. & ECON. 215, 218 (2002).

75. Ascribing the doctrine of lesion to "the civil law," without warning of its removal or reduction by nineteenth century codifiers, as done in ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 191, 253 (2d ed. 1997), exemplifies the ambiguities that complicate the comparisons between legal systems. For a detailed analysis, see JUAN MANUEL ABRIL CAMPOY, LA RESCISIÓN DEL CONTRATO POR LÉSION: ENFOQUE DOCTRINAL Y JURISPRUDENCIAL [THE RECISSION OF CONTRACTS FOR BREACH: A DOCTRINAL AND JURISPRUDENTIAL FOCUS] (2003) (Spain).

76. On the principle of abstraction or *Abstraktionsprinzip* that is characteristic of German property law, see, for example, Jürgen Kohler, *The Law of Rights in Rem*, *in* INTRODUCTION TO GERMAN LAW 231 (W. F. Ebke & M. W. Finkin eds., 1996).

contractual freedom with moral principles that the Canonist interpretation of the original Roman concept had previously offered.

Understandably, legislators also tried to shelter legal reform from any reactionary backlash, including the possibility that judges would exert their discretion to decide cases on the basis of abstract principles and against the new rules,[77] thus rendering the reform ineffective and hindering development towards the market economy.[78] Legislators, therefore, subordinated the judiciary to the law and to jurisprudence and restructured the professional career of judges.[79]

Consequently, not only were codes and statutes given priority as a source of law, but the production of binding precedents was allocated to the higher court of appeals, which was conceived, at least originally, more as a court-controlling body than as a proper court.[80] Its function was to supervise the legal interpretations given by lower courts, guaranteeing uniformity, making sentences predictable, and enhancing legal security.[81] Furthermore, no court

---

77. The legislators followed B. de Montesquieu's theory that judges should simply be "the mouth that pronounces the words of the law" (L'ESPIRIT DES LOIS, 1748). Political scientists have gathered considerable evidence on how political views affect sentencing patterns. *See, e.g.*, C. K. Rowland & Bridget Jeffery Todd, *Where You Stand Depends on Who Sits: Platform Promises and Judicial Gatekeeping in the Federal District Courts*, 53 J. POL. 175 (1991); Carol Ann Traut & Craig F. Emmert, *Expanding the Integrated Model of Judicial Decision Making: The California Justices and Capital Punishment*, 60 J. POL. 1166 (1998); and Mark A. Cohen, *The Motives of Judges: Empirical Evidence from Antitrust Sentencing*, 12 INT'L. REV. L. & ECON. 13 (1992).

78. For example, Hayek, among many others, emphasizes that the revolutionaries' distrust of judges and desire of controlling judicial discretion led to both creation of codes, and more formalized legal procedures. FRIEDRICH A. HAYEK, THE CONSTITUTION OF LIBERTY (1960). This is confirmed by recent empirical evidence showing that civil law countries regulate the judicial process more heavily than common law countries. Simeon Djankov et al., *Courts*, 118 Q.J. ECON. 453 (2003).

79. Broadly speaking, judges in civil law countries are appointed just after law school and follow a civil service career, with promotions decided on the basis of either merit or seniority; whereas in common countries experienced attorneys are more often appointed for judgeships. *See* Richard A. Posner, *What Do Judges and Justices Maximize? (The Same Thing Everybody Else Does)*, 3 SUPREME COURT ECON. REV. 1 (1994); and Richard A. Posner, *Judicial Behavior and Performance: An Economic Approach*, 32 FLA. L. REV. 1259 (2005). See Mark Ramseyer & Eric B. Rasmusen, *Judicial Independence in a Civil Law Regime: The Evidence from Japan*, 13 J.L. ECON. & ORG. 259 (1997) for an empirical analysis on judicial incentives in a career system typical of the civil law.

80. For example, "the preparation of draft bills was not the only task of the Conseil d'État in the legislative field. The institution also played a role in interpreting the law through acts which had a general impact. This function of interpreting legislation accentuated and reinforced the role played by the Conseil d'État in establishing the law. The first regulation of the Conseil d'État, dated 5 Nivôse, An VIII (26 December, 1799), in its article 11 provided for the Conseil d'État 'to develop the substance of laws, when questions that have been put to the consuls are referred to it'. The declarations made by the Conseil in the context of this consultative work were known as avis du Conseil d'État (opinions of the Conseil d'Etat). After the Consulate, the Court of Cassation recognized these opinions as having the same autonomy, with regards to the courts, as a law itself. They were not all published however, as Napoleon did not always give his approval and only this approval could give these opinions of the Conseil d'État the force of law" (Fondation Napoleon, *Printed Working Documents of the Conseil d'Etat [1800–1814]*, http://www.napoleonica.org/us/ce/ce_mission.html [last visited May 2, 2008]).

81. *Id*.

had powers to question the constitutionality of legislation.[82] In the French model, even controlling the legality of governmental action was assigned to a quasi-governmental body, the *Conseil d'Ėtat*.[83]

In parallel, the practice of purchasing judicial offices was abolished and judges were converted into civil servants.[84] They started their judicial career young and inexperienced, by passing specific exams after law school.[85] Even today their promotions and salaries increase with seniority and sometimes with discretionary governmental appointments to the higher courts and other public offices.[86] This meant that judges could lose substantial quasi-rents if they opposed the government or, even worse, were expelled from their positions.[87] Compliance was further constrained in some countries by modifying their liability, making judges personally liable if they decide contrary to the statutory law and formally established jurisprudence, and not to dominant doctrinal opinion as before.[88]

In summation, our explanation of why pro-market reformers in civil law countries reduced the discretion of the judiciary lies in the fact that, in such countries, the transition to market economies was relatively more revolutionary and was generally not supported by Ancient Regime judges.[89] Institutional change in England followed a relatively smooth, evolutionary process, which started much earlier and developed over a considerable time span, giving time and occasion for the judiciary to be cultured in the market order.[90] In contrast, judiciaries in Continental Europe were structured with greater central control with a view to achieving and enforcing an intended change, for which judges were largely unprepared.[91]

---

82. Take for example the Swiss Civil Code of 1907. Its first article clearly establishes that if no rule exists the judge should decide according to the hypothetical will of the legislator. Schweizerisches Zivilgesetzbuch [ZGB], Code civil Suisse [Cc], Codice civile swizzero [Cc][Civil Code] Dec. 10, 1907, SR 210, RS 210, art. 1 (Switz.).

83. "So, in spite of the constitutional rules and the difference, which was in principle absolute, between a consultative body and a body with the power to pass a law, the practice of the Consulate and the Empire shows that the consultative role of the Conseil d'Etat was extended in practice to a legislative role that went beyond that of the Legislative Body." (Fondation Napoleon, supra note 80).

84. *Supra* note 79.

85. *Id*.

86. *Id*. For a case of governmental interference see, for instance, Mark Ramseyer & Eric B. Rasmusen, *Why Are Japanese Judges So Conservative in Politically Charged Cases?* 95 AM. POLIT. SC. REV. 331 (2001), who show that Japanese judges who acquit on the grounds of statutory or constitutional interpretation, often in politically charged cases, have worse careers following the acquittal.

87. *Id*.

88. *See, e.g.*, Ley de enjuiciamiento civil of 1881 (1881 Act of Civil Procedure), art. 903-17.

89. ANTONIO GAMBARO, WESTERN LEGAL TRADITION, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 686–91 (Peter Newman ed., 1998).

90. *See supra* note 51.

91. The evolutionary versus revolutionary character of the transition was not the only historical accident having an influence in the adaptiveness of legal systems. Innovation in physical technology after the common law was entrenched may have also reduced the comparative advantage of judicial discretion. The conjecture is that in common law jurisdictions, the market economy was established before the emergence of national markets, which mostly waited until the development of railroads. Most codification in Europe took place when, thanks to the impact of railroads, it was already clear that

D. Current Anti-Market Trends in the Western Legal System

Both common and civil law experienced substantial transformations during the 20th century, such that jurisdictions pertaining to different legal traditions now show remarkable similarities in areas in which they are often supposed to differ. Considerable convergence has also taken place in fields in which legislation is more recent, such as consumer protection or financial regulation.[92] These changes have been interpreted as consequences of a general social shift from a more individualistic economic and social order to a new kind of collectivism.[93] This shift is consistent with our argument because it comes to satisfy an instinctive demand for insurance at a time when the political system was more willing to supply it. Let us see why.

First, from the perspective of evolutionary psychology, the high level of insecurity and, mainly, the exogenous risks generated by the two World Wars and the Great Depression, activated demand for "sharing" solutions, introducing all sorts of welfare mechanisms and creating the mixed-economy systems that have characterized Western societies since the second part of the 20th century.[94] Even if the antecedents of the welfare state go back to the fourth quarter of the 19th century, they arguably did not reach a substantial share of GDP until well into the 20th century. The weight of the state in the economy also differs substantially across countries, but these current cross-country differences seem much smaller than historical differences between the present and the 19th century. Evolutionary anthropology tells us that ancestral human beings relied on social sharing structures for coping with exogenous risks.[95] Understandably, the World Wars and the Great Depression might have triggered a backlash against the free functioning of the market and the introduction of all sorts of state controls and social insurance, and this conjecture finds some support in the parallel events that took place

---

markets would become much wider in scope. Understandably, legislatures strive to provide unified legal standards for the whole of the national market, as local rule-making makes less sense after the development of national markets.

92. *See* Gambaro, s*upra* note 89, at 686, on the more revolutionary character of changes in the civil law and on the synchronicity between common law and civil law in the second half of the 20th century on issues of women's rights, environmental protection, consumer and corporate law.

93. HAROLD J. BERMAN, LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION 34 (1983); JOHN HENRY MERRYMAN, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF WESTERN EUROPE AND LATIN AMERICA 14 (2d ed. 1985). *See also* Alston, *supra* note 36 and textual section on "Ecological Rationality and the Unnaturalness of Markets" above.

94. The *Roosevelt Week*, TIME, July 11, 1932. "Throughout the nation men and women, forgotten in the political philosophy of the Government, look to us here for guidance and for *more equitable opportunity to share in the distribution of national wealth* . . . I pledge myself to a new deal for the American people. This is more than a political campaign. It is a call to arms." (emphasis added).

95. *See* Elizabeth Cashdan, *Egalitarianism Among Hunters and Gatherers*, 82 AM. ANTHROPOLOGIST 116 (1980); Elizabeth Cashdan, *Hunters and Gatherers: Economic Behavior in Bands*, *in* ECONOMIC ANTHROPOLOGY 21 (Stuart Plattner ed. 1989); Cosmides & Tooby, *supra* note 27; Hillard Kaplan & Kim Hill, *Food Sharing Among Ache Foragers: Tests of Explanatory Hypotheses*, 26 CURRENT ANTHROPOLOGY 223 (1985); Hillard Kaplan et al., *Risk, Foraging, and Food Sharing Among the Ache*, *in* RISK AND UNCERTAINTY IN TRIBAL AND PEASANT ECONOMICS 107 (Elizabeth A. Cashdan ed., 1990).

almost simultaneously in countries under civil and common law, as interventionist rules have since then substantially constrained freedom of contract in both systems.[96]

Second, changes in the structure of the political system at the end of the 19th century and the beginning of the 20th, like the introduction of universal suffrage and the development of organized interest groups—from big firms to unions, moved most countries away from an elitist model of democracy, thus introducing cognitive biases into the rule-making institutions, which previous governing elites had learned to suppress. Whatever the direction of causality, the cognitive gap between legislators and judges with respect to anti-market biases was likely to diminish substantially or even disappear as a consequence of the change in the political system that transformed political leaders into political agents.[97] Political systems became, as a consequence, willing to supply "sharing" solutions, even if they were contrary to freedom of contract, market order, and long-term economic prosperity.

1. Changes in Common Law

We argue that these processes are behind the changes in the fabric of American common law, which was substantially altered by decisions by both legislators and judges.

At the legislative level, the "New Deal" of the 1930s marked a radical turning point. The Legislature moved away from the principles of freedom of contract, introduced wide-ranging regulation and administrative oversight of many private economic activities that affected contractual and property rights, and developed an enormous body of administrative law.[98] It brought extensive mandatory legislation in fields of law that had hardly existed before, like labor relations, securities, public housing, social security, and environmental protection.[99]

The New Deal was also a defining moment for the United States Supreme Court, whose will was twisted to endorse the constitutionality of the New Deal package. Crucial elements of the Constitution were reinterpreted, reducing individuals' freedom of contract in many areas, from labor relations to the issuance of financial securities. Consequently, the Supreme Court lost some of its authority as a guardian of the Constitution together with much of its capacity to override the interpretation of regulations issued by governmental agencies. Courts were able to impose procedural restrictions on administrative agencies but were prevented from achieving substantive

---

96. This does not imply that the solution of the 20th century, characterized by constrained freedom and imposed redistribution, is poorly adapted. On the contrary, these economies have been successful in terms of sustained growth rates and social stability. Furthermore, some experimental works support the claim that stable competitive interaction among humans requires some degree of redistribution.

97. For an account that considers the potential influence of evolutionary maladaptation in the legislative market, see PAUL H. RUBIN, DARWINIAN POLITICS: THE EVOLUTIONARY ORIGIN OF FREEDOM ch. 7 (2002); Paul H. Rubin, *How Humans Make Political Decisions*, 41 JURIMETRICS J. 337 (2001); Paul H. Rubin, *The State of Nature and the Evolution of Political Preferences*, 3 AM. L. & ECON. REV. 50 (2001).

98. GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES (1982); Edward L. Glaeser & Andrei Shleifer, *The Rise of the Regulatory State*, 41 J. ECON. LITERATURE 401 (2003); Manne, *supra* note 11; Cass R. Sunstein, *Interpreting the Regulatory State*, 103 HARV. L. REV. 405, 462 (1989).

99. Berman, *supra* note 93, at 34.

results.[100] Even though the Supreme Court has always reinterpreted constitutional provisions in the context of contemporary society, the major change introduced by the New Deal remains a shift to a more redistributive social contract conceived in the midst of the Great Depression. Even though researchers disagree on the extent to which this breaks with traditional constitutional jurisprudence,[101] the fact is that in *United States v. Carolene Products Co.*,[102] the Supreme Court placed the right of property owners in a subordinate category entitled to a lesser degree of protection. This outcome looks more like a considerable doctrinal shift than a mere adaptation to the specific circumstances.

In addition, judicial interpretation, which for centuries had been supportive of freedom of contract, started to constrain it.[103] This happened, for example, with respect to product liability in the U.S. after *MacPherson v. Buick Motor Co.* in 1916, *Henningsen v. Bloomfield Motors, Inc.* in 1960[104] and the application of so-called "enterprise liability," making manufacturers absolutely liable for all accidents arising from the use of their products.[105] This practice motivates carelessness by consumers.[106] With similar dubious arguments of market power, inequality, and unfairness since the *Williams v. Walker-Thomas Furniture Co.* case of 1965, some U.S. courts have also been applying the doctrine of "unconscionability," refusing to enforce clauses that offend the courts' conscience and coming, in the broadest interpretation of the doctrine, amazingly close to using raw versions of the scholastic arguments of Canon law. Something similar is happening in labor law with the tendency of common law courts to require employers to show "just cause" when terminating a contract that includes the default clause of termination-at-will.[107]

2. Changes in Civil Law

Civil law has experienced similar changes, with only minor differences in timing and intensity. In the legislative area, changes have abounded since the 1920s,[108] when corporatism with diverse political agendas but a common anti-market flavor gained power in several

---

100. Manne, *supra* note 11, at 24.

101. BARRY CUSHMAN, RETHINKING THE NEW DEAL COURT: THE STRUCTURE OF A CONSTITUTIONAL REVOLUTION (1998).

102. 303 U.S. 144 (1938).

103. For a summary of the parallel change in legal doctrine and education with the breakdown of the Austinian model, extremely respectful of precedent, and its substitution for Legal Realism in the first part of the twentieth century, see Manne, *supra* note 11, at 20–29.

104. Benson, *supra* note 67, at 92.

105. George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. LEGAL STUD. 461 (1985).

106. *See* Manne, *supra* note 11, at 35 (mentioning the "creation of an edifice of 'implied warranties'" and the "adoption of strict liability in the 1960s").

107. Max Schanzenbach, *Exception to Employment at Will: Raising Firing Costs or Enforcing Life-Cycle Contracts?*, 5 AM. L. & ECON. REV. 470 (2003).

108. The second wave of codification, which started with the twentieth century, is often considered much less pro-market than the first wave—for example in the treatment of lesion. ABRIL CAMPOY, *supra* note 75.

European countries. As a result, state intervention grew in all kinds of private activities. Parliaments were transformed from discoverers of permanent law into representations of heterogeneous private interests.[109] They enacted many transient and mandatory rules in new legislation, in fields similar to those legislated in the New Deal, a process that was reinforced after World War II with the extension of welfare states. Mandatory legislative intervention of old codified law, such as contracts and property, was initially limited but exploded in the 1960s and 1970s. The increased legislative activity converted what was once thought to be a coherent whole into a mass of ad hoc and frequently contradictory rules.[110]

It might be argued that changes against freedom of contract in civil law countries were made easier because these countries entered the 20th century with more powerful legislatures, unconstrained by the rule-making capacity of the common law judiciary. Comparing end results in Europe and the US seems to confirm this interpretation, because interventionism grew more in Europe. The British case, however, throws a doubt by illustrating that, first, the common law is not sheltered against heavy socialization and, second, that a strong legislative power may be the right tool for reinvigorating the market, more so than the relatively discretional but unsophisticated judiciary that contributed to rule out freedom of contract in common law countries by means of judicial activism.

In many civil law jurisdictions, changes in the position of judges have increased their rulemaking powers. First, control over civil law judges has been relaxed and they now enjoy more freedom. Some of the constraints still active in the 19th century, such as personal liability, also have been lifted. Moreover, judicial congestion partially frees them from the implicit control of appeals, which have become much more costly because delays have increased with the growing opportunity cost of time. Lastly, the previously mentioned change in the nature of parliament has explicitly enhanced the position of judges, especially when constitutions safeguard the positive rights of some groups (civil servants, churches, unions, etc.), constraining legislative discretion.[111] This is clear in constitutional courts, which were designed to control the legislature, and whose powers were reinforced after the Second World War.[112] But lower level courts now also enjoy greater discretion in some jurisdictions, as they now can start proceedings at the constitutional court by questioning the constitutionality of legislation. Similarly, within the European Union, lower courts can initiate a similar proceeding at the European Court of Justice when they believe that national law contradicts EU law. If our cognitive argument on judicial failure is correct, this greater discretion of civil law courts will likely be used to constrain freedom of contract, unless the judges achieve a better understanding of market mechanisms.

---

109. SCHMITT, *supra* note 37.

110. BERMAN, *supra* note 93, at 35–38.

111. SCHMITT, *supra* note 37.

112. For a theory about the role of the constitutional court in controlling legislation that might reduce the protection of rights by the state, see ROBERT ALEXY, TEORÍA DE LOS DERECHOS FUNDAMENTALES [THEORY OF FUNDAMENTAL RIGHTS] (1993) (Spain).

IV. A CRITIQUE OF ALTERNATIVE EXPLANATIONS

Our interpretation of 19th century civil law as an adaptive top-down introduction of the institutions supporting market exchange has important consequences for the arguments developed in debates on the comparative efficiency and performance of common law versus civil law. The first of these debates started when part of the American "law and economics" school argued in favor of the efficiency of the solutions being used in 19th century common law. Later, the quest for institutional explanations of differences in economic performance has led to quantitative comparisons of multiple performance indicators across legal systems. Even though both of these explanations involve evolutionary arguments and path-dependency, they differ in an important way from our hypotheses because they do not consider the possibility of adaptation to local historical circumstances as the main force behind divergent legal systems. Moreover, these alternative explanations fail to prove the universal superiority of common law arrangements which many of them more or less explicitly advocate. Consequently, their explanations can lead to flawed policy when they neglect local circumstances that might strongly limit the feasibility of any legal reform.

A. The Efficiency Debate

1. The Efficiency of the Common Law

The efficiency of common law was first suggested by Posner, based on the metaphor that the decentralized creation of common law mimicked how the market worked, leading judges to unconsciously pursue an efficiency standard.[113] This hypothesis has been successfully used to explain many common law rules, such as those concerning negligence, contributory negligence, strict liability, restitution, and collateral source, to name just a few.[114] For instance, Landes and Posner illustrate the argument by examining the application of the Hand Formula, a special type of cost and benefit analysis applied in the field of torts, and conclude that judges do actually, even though not necessarily consciously, use this method when assessing liability, and thus take efficiency-enhancing decisions.[115] This kind of argument has been criticized, however, for its lack of verifiability. In particular, there is no evidence that judges consciously perform this calculation. Furthermore, the information needed to apply the rule is not readily available. In addition, even if a rule in common law is shown to be efficient, it does not follow that it is the common law system that has produced such efficiency, as many of these rules that were developed in older legal systems[116] are also applied in civil law jurisdictions[117] or, when different, differences are functional and fit well into other design features of legal systems.[118]

---

113. Posner, *supra* note 7.

114. Posner, *supra* note 7.

115. WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW (1987).

116. Brian Simpson, *English Common Law*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, *supra* note 15, at 57.

The efficiency hypothesis has also been grounded in more detailed models of the judicial process. Adapting Harold Demsetz's seminal argument on property rights,[119] Paul Rubin argued that inefficient rules tend to be abolished as an unintended by-product of litigation between self-interested parties who share a common interest in changing the rule.[120] To encompass cases in which parties do not share such a common interest, the argument has been extended to model the common law as an evolutionary process.[121] Litigation, however, is often unable to produce the same legal rules as those that the parties would have introduced if they had explicitly agreed *ex ante* on the issue being litigated *ex post*, because litigation does not aggregate all parties' interests and can therefore aspire to achieve only local, instead of global, efficiency.[122] Taking into account this critique and extending the argument, Rubin argued that ingrained, albeit different, mechanisms drive both common law and civil law to efficiency. He claimed that this drive to efficiency lasted well into the 19th century and that the susceptibility to interest group pressure that characterizes the later evolution of rule-making institutions corrupted both common law and civil law.[123] This idea has been explored further by Crew and Twight,[124] Bailey and Rubin,[125] and Osborne,[126] among others. However, it remains silent on why the two centuries differed so drastically in terms of the extent of rent-seeking, something that we have conjectured may have been a reaction against exogenous risks.[127]

Furthermore, common law understood as judge-made law may be imperfect for deeper reasons. Its nature is retrospective and thus unsuitable for creating completely new rules or for making rapid legal changes. As with any design produced in an evolutionary process, it suffers path dependency because innovations are introduced not by designing them from scratch but by tinkering with a received solution. Paraphrasing Tooby and Cosmides, common law then evolves "like the proverbial ship that is always at sea. The ship can never go into dry dock for a major overhaul; whatever improvements are made must be implemented plank by plank, so that the ship does not sink."[128] Statutory law, in contrast, is produced in a more purposeful, even though

---

117. Michael Faure, *Tort Liability in France: An Introductory Economic Analysis*, *in* 6 THE ECONOMICS OF LEGAL RELATIONSHIPS SERIES 169 (Bruno Deffains & Thierry Kirat eds. 2001).

118. Rubin, *supra* note 5.

119. Harold Demsetz, *Towards a Theory of Property Rights*, 57 AM. ECON. REV. 347 (1967).

120. Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977).

121. Katz, *supra* note 2; Priest, *supra* note 2; Terrebonne, *supra* note 2.

122. Richard E. Wagner, *Common Law, Statute Law and Economic Efficiency*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 313 (Peter Newman ed., 1998).

123. Rubin, *supra* note 5.

124. Michael Crew & Charlotte Twight, *On the Efficiency of Law: A Public Choice Perspective*, 66 PUB. CHOICE 15 (1990).

125. Martin Bailey & Paul H. Rubin, *A Positive Theory of Legal Change*, 14 INT'L REV. L. & ECON. 467 (1994).

126. Evan Osborne, *What's Yours Is Mine: Rent-Seeking and the Common Law*, 111 PUB. CHOICE 399 (2002).

127. For an extensive review of the literature on the efficiency of judge-made law, see Paul H. Rubin, *Judge-Made Law*, *in* 5 ENCYCLOPEDIA OF LAW AND ECONOMICS, *supra* note 2, at 543.

128. Cosmides & Tooby, *supra* note 26, at 60.

not necessarily superior, process, benefiting from planning and foresight, and is less constrained by the previous legal order. It suffers from rent seeking, but, as we have seen above, the severity of this rent-seeking problem varies greatly and the evolutionary processes in common law are not at all free of their own versions of it, as in the case of politically motivated judges, who implement their own version of morality.[129] Even Richard Posner concedes that "legislative law-making is apt to be more efficient than judicial law-making" because the litigation of cases often fails to raise the pertinent questions for initiation of a legal reform.[130] As argued by Wagner, common law can probably pass the test of local efficiency but is bound to fail the test of global efficiency.[131]

Lastly, the claim that case law is more efficient than statutory law remains unproven because most of the discussion has been on the internal consistency of common law and not on its advantages with respect to civil law. Internal consistency, however, is not exclusive to common law, as many rules in civil law also seem to reflect or lead to efficiency.[132] Robert Cooter, for example, suggests that the efficiency of common law depends on the enactment of efficient customs by judges.[133] This is as much a characteristic of common law as it is of civil law. According to this argument, judges make common law efficient when they find customary law and raise it to the level of law. However, the selection of social norms is also frequently carried out in the codification process. For example, the most successful U.S. code, The Uniform Commercial Code, was built by identifying and systematizing the best business practices, and most of the rest of the common law of contracts has also been codified in the Restatement of Contracts published by the American Law Institute and state statutes revising the Statute of Frauds.[134] This argument leads us to the debate of the efficiency of statutory law.

2. The Efficiency of the Civil Law

Work asserting the economic efficiency of the common law often suggests, more or less implicitly, that statutory law does not achieve the same degree of efficiency. However, civil law also strives toward efficiency through its sources of rules, legislation and judicial activity.[135]

Legislation may produce superior rules because its centralization favors standardization and innovation. Industrial organization shows that markets do not always provide universal standards and do not fully guarantee that the surviving standard is the best. A possible solution is an industrial agreement or other kind of coordination mechanism guaranteeing the compatibility of all elements of the network. By analogy, Harnay sees legal codes as standards within a social

---

129. ROBERT H. BORK, THE TEMPTING OF AMERICA (1990).

130. Posner, *supra* note 7, at 569.

131. Wagner, *supra* note 122, at 315.

132. Faure, *supra* note 117, at 179; Harnay, *supra* note 16.

133. Robert Cooter, *Structural Adjudication and the New Law Merchant: A Model of Decentralized Law*, 14 INT'L REV. L. & ECON. 215 (1994).

134. COOTER & ULEN, *supra* note 75, at 205, 378.

135. In a survey among members of the American Law and Economics Association, it was found that eighty-four percent of respondents believed that common law is generally efficient and that forty-two percent thought that it is more efficient than civil law. Moorhouse et al., *Economics and the Law: Where is There Consensus?*, 43 AM. ECONOMIST 81 (1999).

network, providing legal coordination in a setting of adopting externalities.[136] Codified law can then avoid the emergence of inefficient legal rules in the process of decentralized litigation that characterizes common law systems. The argument has been applied to explain codification as a conscious effort to systematize and organize previous statutes and customs.[137] Civil law is also thought to have some advantages, prospectively being more innovative than common law. It is grounded on legal rules, which may be easier to create than social norms.[138] Although this argument obviously begs the question as to whether or when this creativity is desirable, it also indicates that civil law has the potential to be flexible despite being often perceived as rigid.

The concept that civil law is more concerned with distribution than with efficiency has also been opposed by pointing out the extent to which civil law principles rely on a logic of economic efficiency.[139] For example, even though French tort law does not use a Learned Hand test to evaluate the standard of care, it does not exclude the use of cost and benefit analysis. Furthermore, it is questionable whether judicial practice strays away from economic efficiency and favors redistribution more in civil than in common law. For example, it has been argued that civil law tends to apply strict liability when this application is more consistent with compensating victims than with economic efficiency, perhaps reflecting different social priorities.[140] However, the scope of strict liability has probably also been taken in common law to inefficient extremes.[141]

The capacity of civil law judges to modify and adapt inefficient legal rules is also greater than it might be imagined because judges retain some normative capacity.[142] It has often been observed that, when the efficiency of a codified rule is in doubt, civil law courts end up circumventing it, usually by stretching the interpretation of flexible standards such as "good faith," "reasonably," "fairly," and so on. This happened, for instance, in areas as diverse as encroachments, ostensible possession, and formal contract requirements. For example, according to the Spanish Civil Code, encroached constructions should be demolished if the two neighboring owners do not reach an agreement, which would be inefficient in cases of minor good-faith encroachments; consequently, the jurisprudence came to enforce a liability rule.[143] It is also common for land registration laws to deny property (that is, real or *in rem*) status to mere possession. However, case law often interprets good faith requirements expansively, considering ostensible possession as proof of bad faith on the part of a third party acquiring the property from

---

136. Harnay, *supra* note 16.

137. *See, e.g.*, Jean-Michel Josselin & Alain Marciano, *The Making of the French Civil Code: An Economic Interpretation*, 14 EUR. J.L. & ECON. 193 (2002).

138. Nuno Garoupa, *An Economic Analysis of Criminal Systems in Civil Law Countries*, *in* 6 THE ECONOMICS OF LEGAL RELATIONSHIPS SERIES 199 (Bruno Deffains & Thierry Kirat eds. 2001).

139. Faure, *supra* note 117.

140. *Id.*

141. Priest, *supra* note 105.

142. Theodor Viehweg von Beck (TOPIK UND JURISPRUDENZ 1953) argues that civil law judges have freedom to interpret the law.

143. Cándido Paz-Ares, *Principio de eficiencia y derecho privado* [*Principle of Efficiency and Private Rights*], *in* 3 ESTUDIOS EN HOMENAJE A M. BROSETA PONT [STUDIES IN HOMAGE TO M. BROSETA PONT] 2843, 2860–65 (1995) (Spain).

a registered owner without possession.[144] As a last example, the French Civil Code's requirement of written form for debts in the area of business contracting was rapidly abrogated by judges.[145]

It therefore seems clear that efficiency and departures from it are not exclusively a common law or a civil law trait[146] but are responses to deeper causes. Ugo Mattei suggests, for instance, that changes in the role of both common and civil law courts have resulted in the substitution of social organization by contract for what he describes as "government by judges".[147] The result of this shift and the risks involved in it show remarkable similarities across legal traditions. In civil law countries, jurisprudence soon reintroduced moralistic views by interpreting, more or less freely, the original "intent" of the legislative rule maker. In a recent example, courts' rulings on cases involving workers' dismissals in Italy have been shown to be influenced by conditions in the local labor market. The probability of a ruling in the worker's favor increases with the unemployment rate in the court's jurisdiction, which is consistent with greater consideration of "fairness" in such rulings.[148] However, similar events take place in most areas of common law. Even U.S. federal judges have been severely criticized for implementing their own views and disregarding the constitutional and statutory constraints they are supposed to be bound by.[149]

B. The Comparative Performance Discussion

The debate on the efficiency of legal systems, confined for decades to law and economics, has recently reached wider audiences, when some related hypotheses started to be tested empirically by Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, Paul Mahoney, Andrei Shleifer, and Robert Vishny.[150] These works classify a sample of countries according to the historical origin of their legal system as common law or civil law. These studies examined French, German, and Scandinavian civil law, and the origins in former Socialist countries; and then using statistical regression, tested the explanatory power of these "legal origin" variables on diverse indicators of countries' institutional and economic performance, ranging from stock ownership concentration to economic growth.

---

144. The judicial proclivity to transform "crystal" property rules into "muddy" liability rules, was originally analyzed in common law by Rose. Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577 (1988). But it is also present in civil law. *See generally* Arruñada, *supra* note 70.

145. Danet, *supra* note 74. Even if this judicial overruling of statutes is a powerful force, we are not arguing that it equates the position of civil law judges to that of their common law counterparts. Furthermore, such overruling is not always efficient, as shown by the judicial treatment of possessory rights.

146. Rubin, *supra* note 5.

147. MATTEI, *supra* note 73.

148. Andrea Ichino et al., *Are Judges Biased by Law Market Conditions?*, 47 EUR. ECON. REV. 913 (2003).

149. BORK, *supra* note 129.

150. Simeon Djankov et al., *The Regulation of Entry*, 117 Q.J. ECON. 1 (2002); Djankov et al., *supra* note 77; Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); La Porta et al., *supra* note 3; La Porta et al., *supra* note 41; Mahoney, *supra* note 4.

The first studies explored the relevance that this classification criterion had on the development of financial markets and companies' ownership dispersion.[151] Five-scale indices of investor and shareholder protection were elaborated after inspecting the commercial code and bankruptcy regulation in each country. These were assumed to reflect the degree of legal protection that the law was providing to minority investors. A statistically significant positive correlation was found between the shareholder and investor protection, on the one hand, and the common law tradition, on the other. The analysis was later extended in a series of works that showed significant correlations between belonging to a particular legal system and the measured level of regulation, property rights protection, the efficiency of government, the level of political freedom, economic growth, and judicial independence.[152] The punch-line in all these works is that the civil law tradition and, in particular, its French version, shows consistently worse performance than the common law tradition.[153]

This line of research is valuable because it is a pioneer effort in quantifying differences in performance across the legal institutions that sustain modern economies, and this motivates further discussion and allows it to proceed in a more systematic, although some would claim distorted, fashion. However, it suffers substantial weaknesses related to measurement difficulties, selection bias, and questionable causation.

First, measurement is only as valuable as its accuracy, and measuring institutions is bound with methodological difficulties. Thus, most findings are based on indices that capture only a few of many relevant dimensions, as the index of shareholders rights in La Porta *et al.*, which does not distinguish between the mandatory or default character of the rules, a major oversight if they are to be properly understood.[154] In addition, they measure shareholder rights along dimensions that do not necessarily capture the real degree of protection. For example, their index considers the fact that German shareholders cannot vote by mail as a shortcoming of German corporate law, disregarding the fact that most German shareholders send their instructions by mail to their banks and that banks do vote.[155] In fact, if, as shown by Spamann, the "Anti-director Rights Index" from La Porta *et al*.[156] is consistently coded, there are no differences between common and civil law countries' practices.[157] Moreover, it is argued that severe endogeneity problems are present in later works, starting with Djankov *et al*., where new variable definitions are used for the Anti-director Rights Index.[158] The problem is even worse,

---

151. Rafael La Porta et al., *Legal Determinants of External Finance,* 52 J. FIN. 1131 (1997); La Porta et al., *supra* note 3.

152. Rafael La Porta et al., *The Economic Consequences of Legal Origins*, Nat'l Bureau of Econ. Research, Working Paper No. 13608 (2007).

153. *Id*.

154. La Porta et al., *supra* note 3.

155. Mark J. Roe, *Corporate Law's Limits*, 31 J. LEGAL STUD. 233 (2002).

156. La Porta et al., *supra* note 3.

157. Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s 'Anti-Director Rights Index' Under Consistent Coding*, Harvard John M. Olin Ctr. for Law, Econ., and Bus. Fellows' Discussion Paper Series, Discussion Paper No. 7 (March 2006).

158. Simeon Djankov et al., *The Law and Economics of Self-Dealing,* Nat'l Bureau of Econ. Research, Working Paper No. 11883 (2005), *available at* http://post.economics.harvard.edu/faculty/shleifer/papers/selfdeal.nov.pdf.

however, for what is lacking is a global measure of institutional performance that distinguishes between institutional conditions and outcomes, and takes into account interactions among a number of institutions, which determines what we define as a present-day common law or civil law jurisdiction.[159]

Second, even if performances were perfectly measured, their comparisons suffer from an intrinsic self-selection problem because actual observed levels of performance result from those choices that were effectively taken in the past, and we lack information on their alternatives ('baseline difference' in the taxonomy provided by Przeworski).[160] If we recognize that not all legal systems perform well in all contexts, the relevant comparison is between the performance of the chosen option and that of its alternatives, but these alternative performances are by definition never observed. For example, even if someone demonstrates that the economic performance of the U.S. is better than that of France because France has a civil law system, this would not prove that it was a mistake for the French to mold their Ancient Regime legal system in the direction of what is now known as civil law. To show that such a move was a mistake, one would have to compare the actual performance of France with the performance France would have exhibited under common law. This problem could be solved if we could observe cases in which countries choose their legal system randomly, and some research relies on ill-justified claims along these lines.[161]

More generally, advancing causation arguments are especially dangerous in the absence of theory on the function of the specific institution under analysis. For example, concluding from a correlation that concentrated ownership is due to allegedly weak legal protection of investors' rights might look intuitively correct but it is ungrounded. Specifically, when dealing with

---

159. Some steps toward more detailed analysis have already been taken but their results are not free from the biases we outline here. *See, e.g.*, Daron Acemoglu & Simeon Johnson, *Unbundling Institutions*, 113 J. POL. ECON. 949 (2005) (showing a statistical relationship between growth and protection of property rights against state expropriation but not between growth and the quality of contracting institutions, a variable that other works link to legal origin); Daron Acemoglu et al., *Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution*, 117 Q.J. ECON. 1231–32 (2002) (defending the primary importance of local conditions for the development of strong property rights institutions); Thorsten Beck et al., *Law and Finance: Why Does Legal Origin Matter?*, 31 J. COMP. ECON. 653, 655 (2003) (defending the importance of the legal system's adaptability to evolving economic conditions).

160. Adam Przeworski, *Institutions Matter?*, 39 GOV'T & OPPOSITION 527, 537 (2004).

161. In particular, La Porta et al. claim that their studies do not suffer endogeneity because, in most cases, the actual origin of the legal system is imposed by conquest. La Porta et al., *supra* note 3, at 1126; La Porta et al., *supra* note 41, at 264–65. This is doubtful, however, because it is not applicable to either colonizing powers or to many former colonies, which often enacted their codes long after independence—in the case of former Spanish colonies, many decades later (and, by the way, choosing a perplexing mix of Spanish legal institutions and American political institutions). In addition, even when introducing new legal institutions, there was a choice of system and the decision was often to delay application to the colonies, implicitly opting to temporarily maintain the older system, which provided greater judicial discretion. Furthermore, as a version of this self-selection problem, the legal origin variables fail to consider the indigenous legal institutions. Daniel Berkowitz et al., *Economic Development, Legality and the Transplant Effect*, 47 EUR. ECON. REV. 165 (2003). The prior strength of indigenous institutions, which made introducing Western law unnecessary, more costly, and less effective, has also often been disregarded as an explanatory factor. *See* Acemoglu et al., *supra* note 159 (regarding the potentially negative effect of pre-colonial institutions in long-run economic growth).

institutions of considerable complexity such as legal systems, it might not be possible to hold all other variables constant. As Roe shows, a complex mix of economic, social, and political conditions affects and is affected by managerial agency costs and determines the degree of ownership dispersion.[162] Something similar happens with a recurrent omission in this literature: that civil law is grounded more on *ex ante* legal enforcement and gatekeeping while common law relies more on *ex post* judicial control of transactions that are freer *ex ante*. Given its reliance on *ex ante* control, civil law tends to require more mandatory procedures for most contracts. Consequently, comparisons of the complexity and cost of transactions across both legal systems is subject to a grave doubt. Similarly, the methodology of the "Doing Business" initiative computes only the mandatory steps necessary to incorporate a company, instead of computing the standard steps, assuming that the founders of a company undertake all necessary procedures by themselves, at no cost, unless it is mandatory to have an external party involved.[163] Its evaluation of national institutions is therefore biased in favor of those countries with minimal mandatory intervention: probably, those relying on *ex post* legal control, for which "Doing Business" assumed entrepreneurs get legal help for free. In addition, the possible effect of *ex ante* intervention in reducing legal costs *ex post* is ignored.[164]

In the same way, legal systems are imbedded into a complex network of political structures and social preferences that cannot be studied in isolation. Apparently La Porta *et al.* do study them in isolation when they take as a symptom of inefficiency of the legal procedure their finding that courts in civil law countries are slower to decide a case of eviction of a tenant or collection of a bounced check. Suggested inefficacies, however, are difficult to substantiate without considering factors such as the incidence of these events, the complementary enforcement mechanisms that are at work, and the costs incurred in each system for a comparable level of quality.

Within this literature, the superior economic performance of common law countries has been attributed not only to the statutory protection of property rights but also to the greater judicial independence supposedly enjoyed by common law judges.[165] However, the benefits of greater judicial independence and, as a consequence, the inferred relationship with economic performance have been severely questioned in a period where politically-motivated judges implement their notion of fairness and morality in an institutional setting in which they are not accountable, to a considerable degree, to anybody.[166]

Lastly, causation is also in doubt when superior performance is attributed to common law in legal fields which are based on statutory law everywhere. This happens not only in corporate law, but also in regulation and administrative law, as well as with some specific indicators, like eviction time. With this in mind, it is unsurprising that these legal origin variables also "explain"

---

162. Roe, *supra* note 155, at 265–69.

163. Simeon Djankov et al., *The Regulation of Entry*, 117 Q.J. ECON. 1, 2 (2002); WORLD BANK, DOING BUSINESS IN 2004: UNDERSTANDING REGULATION 105, 106–07 (2004).

164. BENITO ARRUÑADA, LA FORMALIZACIÓN DE LA EMPRESA [THE FORMALIZATION OF ENTERPRISE] (forthcoming 2008) (Spain).

165. Rafael La Porta et al., *Judicial Checks and Balances*, 112 J. POL. ECON. 445, 464 (2004).

166. BORK, *supra* note 129, at 4–5.

such phenomena as sports success,[167] showing once more that correlation does not imply causation.

C. The Need for Further Detail

More generally, both the efficiency and performance debates opposing common and civil law have been formulated at a high level of abstraction. This may lead to a focus on ambiguous categories and reach mistaken conclusions. This abstraction takes place both vertically and horizontally.

Vertically, because the various "civil law" labels are defined by country and, are therefore applied to related but separate and historically variable phenomena, such as statutory, codified, and systematic law versus case law, mandatory rules versus default rules, judicial dependence versus judicial discretion, and even rigid versus flexible rules of judicial procedure. These dimensions are better seen as variables in institutional design. All legal systems use them as ingredients but mix them in different proportions and manage them differently through history. Comparison among systems should aim to consider the weight of each ingredient, and their interdependencies. In doing so, the analysis should ideally incorporate the institutional determinants that lie beyond the legal system and frequently are found in the nature of the political process,[168] as well as wider economic factors relevant in specific fields of law, such as property, expected number of transactions, risk of political opportunism, and regulatory consistency.[169]

Something similar happens horizontally, as legal systems often adopt structures pertaining to foreign traditions. This is also clear in the field of property law, in which legal traditions do not explain the adoption of the most relevant institutions. For example, until recently England had a system of private transactions akin to that of the Romans, but moved in the last century to the German system of registration, which is the same as Australia and most of Canada. Most of the U.S., however, introduced a system of publicity by recording that is typically French.[170] Similarly, the *numerus clausus* of property, *in rem* rights are now almost unrelated to the common versus civil law divide. It remains to be documented to what extent this institutional cross-breeding also happens in other fields of law.

---

167. West finds that FIFA rankings of national soccer teams correlate in a statistically significant manner with the legal origins a country belongs to. Mark West, *Legal Determinants of World Cup Success* (Univ. of Mich. Law Sch., Working Paper No. 02-009, 2002).

168. Jürgen G. Backhaus, *Efficient Statute Law*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, *supra* note 15, at 24; Wagner, *supra* note 122, at 313; Richard E. Wagner, *Crafting Social Rules: Common Law vs. Statute Law, Once Again*, 3 CONST. POL. ECON. 381 (1992).

169. Arruñada, *supra* note 70.

170. *Id.*

V. Concluding Remarks

It is time now to present some policy considerations, which aim to be pertinent for the unsolved problem of how to build market institutions in transition and developing economies.

In previous sections we argue that the evolution of both common and the civil law in the 19th century was instrumental in protecting freedom of contract and developing market economies. Furthermore, we explain the different degrees of discretion granted to courts in both systems as optimal adaptations to particular circumstances, partially to the availability of judges favorable to the market in England and their lack in the Continent. In this way, greater judicial discretion in classic common law courts emerges more as an historical and perhaps unique exception than as a replicable solution.

This casts an additional doubt on the normative interpretations of some results on the efficiency and performance of legal systems, which, asserting the superiority of the common law, seemingly recommend applying it. We have sketched above why such superiority is open to question and likely to depend on environmental factors. But, more clearly, even if the common law were shown to be superior now, the normative consequences of such superiority might be insignificant. Both common and civil law were probably well adapted to their original circumstances. Those creating the institutions of the market in Continental Europe did not opt for constraining judicial discretion to control the market but to protect it.

In line with this contingent interpretation, our analysis does not advise any specific system for transition and developing economies in general but instead suggests that institutional development and academic research should aim at identifying the contextual circumstances which affect the costs and benefits of the different solutions. The problems of these economies may, in some cases, be more similar to those faced on the Continent at the demise of the Ancient Regime than to those enjoyed by England more or less at the same time. If so, restraining judicial discretion may be now necessary in developing economies to guarantee freedom of contract.

In addition to the need for adaptation, our analysis suggests that the creation of market friendly institutions in transition and developing economies would benefit from examining the presence or absence of a cognitive gap similar to the one alleged between European legislators and judges in the 19th century. The lack of market-wise judges can be safely assumed in many transition and developing economies. The existence of elites having a clear idea of the market probably does not vary substantially among countries. However, the role of these elites in government differs with the nature of the political system. Such elites may be allowed to lead the transition (as in some cases in Asia) or, on the contrary, they may be sidestepped by governments acting as mere political agents of ill-informed voters (as, e.g., in much of Latin America).

Lastly, if we are correct in considering both legal systems as adaptations to local circumstances, our analysis points out the risk that the debates on the relative efficiency and performance of common and civil law may be sterile and even have a perverse consequence. Sterile, because the comparison does not take place between viable alternatives. Perverse because, by emphasizing differences between common and civil law, this literature may be distracting the attention from a much more important issue—what seems to be a creeping debasement of the pro-market fundamentals of both branches of the Western legal system or, more optimistically, a sort of equilibrium between the efficiency of rational markets and our redistributional instincts.