Common Law *vs* The Civil Code: The Silver Lining to Cloudy Legal Standards

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Version 1.1 — December 4, 2001

*I am grateful to Tom Romer and to seminar participants at Yale University for comments on an earlier version of this paper.

Abstract

This paper illustrates the potential for the faithfulness to legislative intent of civil law enforcement to impede economic growth as compared with common law enforcement. Common law courts are less predictable, but this has the advantage of making them less malleable in the hands of a legislature that seeks to tilt contract law in favor of supporters. The model's prediction that judicial discretion constrains opportunistic legislation is consistent with the finding that countries using the German version of civil law, which allows judges more leeway than in the French version, but less than in English common law, are also intermediate in economic performance.

Introduction

Perhaps the central distinction between civil law and common law systems is their handling of the tradeoff between legislative rules and judicial discretion. The civil law ideal calls for laws that are so clearly written that all can understand them, with judges simply acting as clerks who implement the obvious. In contrast, common law systems give judges considerable leeway in tempering the law in the interests of justice being done in each particular case.[1]

On *a priori* grounds we might expect that the more transparent civil law system would be preferable; over time unjust or badly written laws can be identified and repealed or rewritten, whereas the passage of time creates opportunities for common law judges to "legislate from the bench" through the accumulation of legal precedents. Likewise, there is little reason to suppose that common law judges, with their considerable discretion, will be less venal than their highly constrained civil law counterparts.

The empirical record tells a different storyLa Porta et al. (1999) find that, after adding various controls, countries using some variant of English common law tend to fare better than those using German civil law, a version of the civil law system that allows more leeway for judicial discretion, while these in turn perform better than countries using the legal system of France, where judicial discretion is more thoroughly circumscribed. Moreover, this finding survives closer scrutiny: in other work the same authors(La Porta et al., 1998) find that countries using some variant of English common law have the strongest laws to protect corporate investors, while countries influenced by the French civil code are least protective of investors rights. La Porta

[1] As might be expected of a subject of interest to professional advocates, legal scholars in each tradition have taken the position that there is no tradeoff between equity and efficiency, and that one system is simply and clearly superior. Nevertheless, most advocates of the civil law system emphasize its transparency and predictability, most admirers of common law stress the advantages of judicial discretion.

et al. (2000) find that common law enforcement is also more favorable to investors than is enforcement by the civil law courts.

In this paper I propose a political, explanation for the evident economic advantages of common law enforcement of private contracts among private individuals. For any trade involving goods or services whose quality is not instantly and completely verifiable at negligible cost, the need for enforcement will emerge. As economic activity becomes more sophisticated, trades will tend to involve strangers, among whom informal means of enforcement are not effective. As the scope and complexity of economic activity expand, contracts enforced by the courts become indispensable. But when the public courts enforce the terms of private exchanges, the door is open for enterprising legislators to influence the process of enforcement, and so the terms of private exchange, thereby transferring rents to their supporters.

By passing legislation regulating the terms of trade and the standards of proof to be used when disputes arise legislators can alter the terms of private exchanges: What standard of proof is used to determine whether an airplane is in violation of a warranty that it is in "good working order"? Must employers show cause for dismissal? What are the terms at which a lease can be canceled? Can a homeowner default on a mortgage without declaring bankruptcy? When a firm fails, which creditors queue up first to settle their claims against the firm's remaining assets? What remedies are available to minority stockholders in a firm (La Porta et al., 1998)? What laws govern the resolution of conflicts between of stockholders and stakeholders (La Porta et al., 2000)? The answers to these and countless questions like them affect the welfare of virtual every individual in society. Politicians can transfer considerable rents by "tilting" these rules in favor of their supporters, albeit at the cost of reduced economic efficiency.

The argument here for the relative economic efficiency of common law systems rests on the inefficiency and unpredictability of the common law courts

when they execute the will of the legislature, as compared with the more faithful and predictable enforcement carried out by the civil law courts. If surplus is to be transferred *via* the leaky bucket of common law enforcement, transfers become less attractive as a means for politicians to attract votes and stimulate contributions. The greater difficulty of shifting the weight of the law in favor of political supporters in common law systems reduces the incentives to pass economically inefficient legislation.

I do not claim that this is the only mechanism by which common law enforcement may help to foster economic activity, and after presenting the model I compare it with some interesting alternative explanations in the literature. My purpose here is to illustrate that the growth inhibiting tendency of civil law enforcement need not result from the civil law courts failing to live up to their promise of efficient execution of the law. Instead, it may be the very efficiency of the civil law courts at administering the law, as compared with their common law counterparts, that tempts legislators to engage in politically expedient but economically inefficient regulation, ultimately acting as a check on economic growth.[2] In what follows, a democratic form of government is assumed to prevail.

The next section of this paper sketches a model of court enforcement of private transactions. Section Two introduces a legislator who modifies the enforcement of promises made as part of private transactions, something it can do very effectively with the help of the civil law courts. In Section Three attention turns to the common law courts, and the analysis shows that

[2]This raises numerous questions about what "common law" really means during periods of non-democratic rule. Merryman. (1969) suggests that the greater autonomy of judges in Germany made them *more* responsive to the Nazi government, while their putatively more constrained Italian counterparts were better able to resist that country's fascist government. He indicates that while Italian judges could "hide behind the law" when making rulings unfavorable to the government, the German judges could not disguise their discretion, and so, if they wished to remain employed, they were not able to rule against the government. Of course, the very possibility that civil law judges could "hide" behind the letter of the law means that they have at least some leeway for individual discretion. The key to the argument set forth here is not the civil law judges lack discretion, but rather that they have less of it than their common law counterparts.

idiosyncratic enforcement by the common law courts curbs the legislator's appetite for opportunistic intervention. I then compare the results developed here with some related work by others, while a final section concludes.

A Model of Voluntary Trade and Court Enforcement

While the legal system considers a wide array of cases involving economic exchanges, it is useful here to construct a prototypical model of such an exchange. Such a model inevitably sacrifices some interesting details to the goal of simplicity. While I will describe an exchange between a farmer and an artisan, similar economic relationships exist between buyers and sellers, borrowers and lenders, employers and employees. The example is meant to stand in for a wide range of economic exchanges.

Suppose that a farmer offers to trade a cartload of grain for a steel plowshare made by an artisan. While both objects are available for inspection at the time of sale, certain aspects of their quality will only become evident later, after the transaction has taken place. In primitive societies *ex post* quality control could be handled by informal means including social sanctions and the potential for retribution in later interactions. But as the scope of economic activity grows individuals become involved in more arms length transactions and failures to provide goods of the agreed upon quality are increasingly resolved through the courts.

To formalize this model, suppose that $r \geq 0$ indicates the quality of the plowshare produced by the artisan, while $q \geq 0$ is the quality of the farmer's grain. The farmer's preferences are given by:

$$U_F(r, q) = u(r) - c(q)$$

where u is an increasing and strictly concave function of the quality of the plowshare purchased by the farmer while c is an increasing and strictly convex function that represents his cost of producing higher quality grain. For

convenience we can normalize the quality level associated with production costs of 0 as $q = 0$.

The artisan has similar preferences:

$$U_A(r, q) = v(q) - e(r)$$

Here v is an increasing strictly concave function of the quality, q, of the grain she buys from the farmer, while w is an increasing strictly convex function of the quality of the plowshare she produces, with zero production costs being associated with a quality level of 0. In addition, it is assumed that u, c, v, and e are each twice continuously differentiable. To guarantee the potential for gains from trade, the functions satisfy the additional constraint that $u'(0) > e'(0)$ and $v'(0) > c'(0)$.

To keep the exposition simple, only the producer knows the quality of each object being traded at the time of the transaction. Thus the farmer knows the quality of his grain, but not the of the plowshare, while the artisan knows the quality of the plowshare she has produced, but cannot observe q, the quality of the grain.

At the moment of the transaction, the farmer promises that the quality of the grain he is selling is at least q_0, while the artisan likewise guarantees that the quality of the plowshare is at least r_0.

After the transaction, the farmer and artisan directly observe the actual quality levels as they make use of their acquisitions. What ensues should either discover the other did not provide the promised level of quality depends on the institutional structure.

The ability of each party to the transaction to refrain constrains the bargain that can be struck. Rather than append a model of continued search to the basic structure set forth here, suppose that if the two parties are unable to agree to a transaction then each receives his or her autarkic payoff,

$u(0) - e(0) = u(0)$ for the farmer, and $v(0) - c(0) = v(0)$ for the artisan. Thus, the participation constraints are:

$$u(r) - c(q) \geq u(0) \tag{1}$$

and

$$v(q) - e(r) \geq v(0) \tag{2}$$

These constraints ensure that the transaction makes each individual better off than he or she would be under autarky.

A Civil Law Benchmark

Let us first consider a set of perfectly working civil law institutions. In this setting either party who discovers that he or she has been cheated can bring the case to court. This imposes a cost of C on each litigant. The judge then observes the actual quality of the good, and the agreed upon quality level. If the quality level exceeds a threshold, q_J for cases involving grain, r_J for cases involving plowshares, the judge finds for the defendant: both sides pay their court costs[3] of C and otherwise nothing is affected. If the quality level falls below the threshold, then the judge requires the defendant to make a transfer to the plaintiff equal to $D + u(r_J) - u(r)$ in cases involving plowshares, or $D + v(q_J) - v(q)$ in cases involving grain. This means that the defendant pays the plaintiff an award of D (which we may think of as "court costs plus", so that $D \geq C$) and compensation for the difference between the actual and promised quality of the good that is delivered.

There are no "synergies" between defending oneself from a suit and launching a suit of one's own, and so the decision of whether to sue can be considered in isolation from the action chosen by the other party. Formally the return

[3]Here I am allowing the court to transfer utility, though I leave the mechanism by which this is accomplished in the background–think if it as some form of forced labor.

to the farmer from suing the artisan for not providing adequate quality is $g(r, r_J) - C$, where:

$$g(r, r_J) = \begin{cases} D + u(r_J) - u(r) & \text{for } r < r_J \\ 0 & \text{for } r \geq r_J \end{cases}$$

The utility for the artisan from being sued is $-g(r, r_J) - C$. It is easy to see that the farmer will sue if and only if $g(r, r_J) > C$. Anticipating this at the production stage, the artisan will seek to minimize the cost of production, $e(r)$ subject to the constraint that $g(r, r_J) \leq C$. This is achieved at $r = r_J$.

Similar calculations establish that the return to the artisan from suing the farmer over the quality of the grain is given by $f(q, q_J) - C$, while the returns to being sued are $-f(q, q_J) - C$, where:

$$f(q, q_J) = \begin{cases} D + v(q_J) - v(q) & \text{for } q < q_J \\ 0 & \text{for } q \geq q_J \end{cases}$$

The farmer will choose grain quality to minimize his production cost of $c(q)$ subject to the constraint that $f(q, q_J) \leq C$. This leads to an equilibrium production decision of q_J.

The Pareto optimal transfer would take place at the quality levels q^* and r^* that maximize total surplus[4], so that:

$$u'(r^*) = e'(r^*) \qquad \text{and} \qquad v'(q^*) = c'(q^*)$$

If people are sufficiently homogeneous, the legislature might simply mandate that transactions take place at the quality levels q^* and r^*, obviating negotiations between the parties to the contract. To resolve ambiguity about the side payments that might be made to sustain a contract, let us assume that the legislature has mandated quality thresholds, and that these are the

[4]Provided, of course, that this pair of quality levels satisfies the participation constraint.

only thresholds the courts will enforce. I also assume that the Pareto Optimal quality levels q^* and r^* satisfy the participation constraints, (1) and (2). This effectively stops the use of side payments–the party receiving the payment cannot commit to providing a quality level higher than that enforced by the court, while either side will enter the transaction even without a side payment provided this transaction satisfies the participation constraints.

With benevolent regulation, civil law judicial enforcement fosters transactions at Pareto Optimal quality. This provides a benchmark for a well functioning market supported by efficient contract enforcement in the courts. Notice also that if there were no courts or other enforcement mechanisms, the quality levels would be set at the cost minimizing level: 0, effectively destroying the gains from trade. Individuals' inability to verify quality at the moment a transaction takes place makes efficient economic activity depend on a system of courts (or some other mechanism) to enforce promises about quality.

Special Interest Group Legislation

Now concider the legislator's incentives to implement policy. Here I shall treat the legislator as a single individual who chooses quality thresholds to maximize a weighted sum of the welfare of the two groups, placing a weight of β on the farmers and $1-\beta$ on the artisans. Grossman and Helpman. (1994) identify one set of legislative institutions that can lead to such an outcome.

This leads the legislator to choose quality thresholds q_L and r_L to solve:

$$Max\beta \left\{u(r) - c(q)\right\} + (1-\beta)\left\{v(q) - e(r)\right\}$$

subject To the participation constraints:

$$u(r) - c(q) - u(0) > 0 \qquad \text{and} \qquad v(q) - e(r) - v(0) > 0$$

Provided the constraints do not bind, so that the imposed solution is not so extreme that it drives one or both groups to the edge of autarky, the legislator will choose q_L and r_L to satisfy:

$$u'(r_L) = \frac{1-\beta}{\beta} e'(r_L) \tag{3}$$

and

$$v'(q_L) = \frac{\beta}{1-\beta} c'(q_L) \tag{4}$$

If $\beta = \frac{1}{2}$ this will yield the Pareto Optimal solution $q_L = q^*$, and $r_L = r^*$. If instead $\beta > \frac{1}{2}$ the legislator will set q_L below the Pareto Optimal level, while r_L is pegged above its Pareto Optimal value: a pro-farmer legislator will adopt laxer standards for farmers, and tougher ones for artisans. Similarly, $\beta < \frac{1}{2}$ will lead to q_L being set above its Pareto Optimal level, while r_L is set below its threshold.

Notice however, that except for the direct impact of the legislation which moves transactions off the Pareto Frontier, the court system imposes no additional dead weight costs. In fact, the civil law courts in this model epitomize the civil law ideal of predictable and efficient enforcement of the law.

Of course, this is a stylized representation. Real civil law judges do retain some discretion. If they did not they would be unable to respond to evidence! My purpose here is to examine the potential shortcomings of efficient and predictable enforcement of legislation by the courts, so allowing the civil law courts in this model to attain such a standard simply makes the consequence of faithful enforcement as stark as possible.

Common Law Enforcement

Now consider a key difference between civil law and common law systems: the importance accorded to certainty. Because common law judges exercise

a more interpretive role than their civil law counterparts the outcome of litigation in the common law courts is less uniform, and less predictable at the moment legislation is passed. The use of juries in the common law system makes outcomes even more heterogeneous. Defenders of the common law system contend that the common law courts attention to the "justice of the case" more than compensates for the extra level of unpredictability entailed by their independence. But where defenders of the common law tradition see justice with a human face, civil law skeptics perceive "justice" with a very human tendency to caprice and corruption.

Here I focus on the idiosyncrasy of the common law courts, and my argument does not depend on the common law courts being better at tailoring their rulings to the mitigating details of each case. To the extent that the common law courts are successful on that dimension, it only strengthens the case of common law courts.

The model incorporates the idiosyncrasies of the common law courts by allowing the thresholds $\tilde{q}_C$ and $\tilde{r}_C$ applied by the common law courts to be drawn from a joint probability distribution with cumulative density function H, which is taken to be continuous. The realized values for $\tilde{q}_C$ and $\tilde{r}_C$ are not known at the time legislation is passed.

We can think of the particular transacting pair of an artisan and a farmer as representative of a large number of similar negotiations taking place in society[5]. Variation in $\tilde{q}_C$ and $\tilde{r}_C$ stems from two sources: variation in the details of the particular cases brought to the courts, and to differences among individual judges in the interpretation of the letter of the law– *e.g* what do phrases such as "proof by a preponderance of the evidence" really mean?

[5]One could interpret the cumulative density function as a formalization of heterogeneity among courts and cases rather than randomness. However, in the analysis that follows there are some genuine random variables, having to do with uncertainty about the way in which newly written laws will be interpreted. This leads to distributions that are amalgams of the *ex ante* distribution of $\tilde{q}_C$ and $\tilde{r}_C$ with no new legislation, and uncertainty about how the courts will interpret an additional infusion of randomness caused by the law. Maintaining the interpretation of the *ex ante* distribution of $\tilde{q}_C$ and $\tilde{r}_C$ as reflecting heterogeneity, it makes discussion of the *ex post* distribution unnecessarily awkward.

What do requirements such as the use of "reasonable care" imply about a supplier's liability for damages during shipping?

Also contributing to the heterogeneity of common law judges are predispositions to rule in certain ways. Consider the idiosyncratic reputations of some judges as tough or lenient sentencers. In some cases these leanings are predictable. Canes-Wrone. (2001) finds evidence that the rate at which the Army Corps of engineers grants permits for wetlands development responds to the partisanship of the judges expected to review decisions. Similarly, Cox and Katz. (2001) find that judges' partisan origins affect the decisions they render in apportionment and redistricting cases. Of course, stacking the judiciary with one's political allies is slow and unpredictable work. Consider Eisenhower's appointment of Earl Warren to the Supreme Court, a decision he later came to repent.

In this analysis the common law courts differ from their civil law counterparts only in their *ex ante* unpredictability at the time legislation is passed. In all other respects the common law courts are treated as operating in the same manner as the civil law courts, with awards levels D, court costs C, and the lack of synergies with countersuits being held equal. Of course, we might expect that the award levels would themselves be more variable in a common law system, that court costs would be higher, and that given the greater complexity induced by the common law courts' attempt to discern the most equitable resolution of the cases being heard, that countersuit synergies would be more important. However, to keep the source of the results clear, I keep all of these factors the same for both systems.

While the legislature knows the shape of the density function H, the actual realizations of this distribution are not observed by the legislature when it passes quality control laws. However, individuals do observe the quality thresholds imposed by the courts before they choose the quality levels they will supply. Thus, any contract that takes place will do so at court imposed

quality thresholds, $\tilde{q}_C$ and $\tilde{r}_C$ that satisfy the participation constraints for the artisan and the farmer[6]

Because the cumulative density function H is continuous their is zero probability that the common law courts impose the Pareto Optimal quality thresholds q^* and r^*. This comports with the civil law criticism that the common law courts' unpredictability inhibits individuals from making efficient contracts.

Status Quo Bias

Of the two sources of variation in rulings by the common law courts noted above: variation in the details of individual cases, and leeway in interpreting the letter of the law, it is the latter that is likely to be be a particularly acute for new legislation, while a body of case law will have developed in connection with older statutes that reduces ambiguity, and limits the opportunities for activist judges. Thus it is useful to formulate the cumulative density function, H, in terms of the *status quo* policy, call it $\vec{\zeta_0}$, and the policy actually implemented by the legislature, $\vec{\zeta}$. The parameters $\vec{\zeta}$ and $\vec{\zeta_0}$ affect the shape of the distribution H.

The expected payoff for the legislator if she implements a policy of $\vec{\zeta}$ is:

$$\int\int \left\{\beta\left(u(r)-c(q)\right)+\left(1-\beta\right)\left(v(q)-e(r)\right)\right\} dH(\tilde{q},\tilde{r},\vec{\zeta},\vec{\zeta_0})$$

Because there are no "countersuit" synergies it is useful to reexpress this in terms of the marginal densities for $\tilde{q}$ and $\tilde{r}$:

$$\int \left\{\beta u(r)-(1-\beta)e(r)\right\} dH_q(\tilde{r},\rho,\rho_0)$$
$$+\int \left\{(1-\beta)v(q)-\beta c(q)\right\} dH_r(\tilde{q},\gamma,\gamma_0)$$

[6]Here I shall ignore the potential for common law enforcement to push at least one party to the contract below his or her participation constraint.

Here γ and ρ are control variables at the disposal of the legislature;

$$\vec{\zeta} = \begin{pmatrix} \gamma \\ \rho \end{pmatrix}$$

The *status quo* levels for the legislature's control variables are ρ_0 and γ_0. The shapes of the marginal densities, dH_q and dH_q depend on γ, ρ, γ_0, and ρ_0. Thus, the legislature is able to influence the courts. However, in contrast with the civil law legislature, this control is imperfect. Whereas the civil law legislature can mandate the same q_L and r_L for all transactions, the common law legislature is merely able to shift the distribution of court imposed quality thresholds. It cannot require uniformity.

The model captures the extra heterogeneity involved in presenting fresh legislation to the common law courts, free from an constraining judicial precedent with the following conditions:

A.) If $\gamma \neq \gamma_0$ then $H_r(\tilde{q}, \gamma, \gamma_0)$ differs from $H_{\tilde{r}}(\tilde{q}, \gamma, \gamma)$ by a mean preserving spread. Moreover, for any continuous concave function $\eta(q)$ that is defined everywhere on the support of H_r the magnitude of $\int \eta(q) H_r(\tilde{q}, \gamma, \gamma_0) d\tilde{q} - \int \eta(q) H_r(\tilde{q}, \gamma, \gamma) d\tilde{q}$ is a decreasing function of $|\gamma - \gamma_0|$.
B.) If $\rho \neq \rho_0$ then $H_q(\tilde{r}, \rho, \rho_0)$ differs from $H_q(\tilde{r}, \rho, \rho)$ by a mean preserving spread. Moreover, for any continuous concave function $\eta(r)$ that is defined everywhere on the support of H_q the magnitude of $\int \eta(\tilde{r}) H_q(\tilde{r}, \rho, \rho_0) d\tilde{r} - \int \eta(\tilde{r}) H_q(\tilde{r}, \rho, \rho) d\tilde{r}$ is a decreasing function of $|\rho - \rho_0|$.

These two conditions imply that the farther the legislator shifts policy from its status quo setting, the greater her uncertainty about the terms on which it will be enforced by the courts.

Now consider the legislator's temptation to amend the *status quo* legislation. It is useful to rewrite the legislator's objective function as:

$$\omega(\rho, \rho_0) + \alpha(\rho) + \psi(\gamma, \gamma_0) + \xi(\gamma) \tag{5}$$

where:

$$\omega(\rho, \rho_0) = \int (\beta u(r) - (1-\beta)e(r))\, dH_q(\tilde{r}, \rho, \rho_0) - \int (\beta u(r) - (1-\beta)e(r))\, dH_q(\tilde{r}, \rho, \rho)$$

The function ω captures the extra increment of uncertainty with respect to the quality threshold r for plowshares that results from uncertainty about the courts' response to a new law. It reports the legislator's loss in expected utility from the newness of the legislation she implements, namely the difference between her utility from implementing a new piece of legislation ρ affecting plowshare quality, r, given the actual *status quo* at ρ_0 and the payoff the legislator would have expected if the new law were already incorporated as part of the *status quo* case law.

$$\alpha(\rho) = \int (\beta u(r) - (1-\beta)e(r))\, dH_q(\tilde{r}, \rho, \rho)$$

The function α reports the expected utility the legislator would receive if there were no extra uncertainty about the courts' implementation of new legislation related to r, the quality of plowshares.

$$\psi(\rho, \rho_0) = \int \{(1-\beta)v(q) - \beta c(q)\}\, dH_r(\tilde{q}, \gamma, \gamma_0) - \int \{(1-\beta)v(q) - \beta c(q)\}\, dH_r(\tilde{q}, \gamma, \gamma)$$

The ψ function is the counterpart to ω, it tells us the expected utility loss suffered by the legislator because of uncertainty about how the courts will interpret new legislation that affects q.

$$\xi(\rho) = \int \{(1-\beta)v(q) - \beta c(q)\}\, dH_r(\tilde{q}, \gamma, \gamma)$$

The ξ function is the counterpart to α, and it reports the expected utility the legislator would receive if there were no extra uncertainty about the courts' implementation of a new piece of legislation affecting q.

From A.) and B.) we know that $\omega(\rho, \rho_0)$ is decreasing in the distance between ρ and ρ_0, holding $\rho - 0$ constant, while $\psi(\gamma, \gamma_0)$ is a decreasing function of the distance between γ and γ_0, with γ_0 held constant.

Maximizing (5) the legislator will choose γ and ρ to satisfy:

$$\alpha'(\rho_L) = -\omega_\rho(\rho_L, \rho_0) \tag{6}$$

and:

$$\xi'(\gamma_L) = -\psi_\gamma(\gamma_L, \rho_0) \tag{7}$$

The influence of uncertainty about the courts' reception of new legislation is captured by the $-\omega_\rho$ and $-\psi_\gamma$ terms, which drive a wedge between the legislation that would maximize $\alpha(\rho)$ and $\xi(\gamma)$, and the levels actually implemented. When α is a concave function of the legislator's policy instrument, ρ, the effect of uncertainty is to induce *status quo* bias. When $\rho_L > \rho_0$, then $-\omega_\rho > 0$, and the value for ρ_L that satisfies condition (6) will be smaller than the value for ρ that sets $\alpha' = 0$; the value the legislator would select absent uncertainty about how the courts would receive new legislation. Likewise, if $\rho_L < \rho_0$ then $-\omega_\rho < 0$ and the legislator will choose a larger value of ρ to satisfy condition (6) than she would to set $\alpha' = 0$. Concavity of ξ produces a similar *status quo* bias in the choice of γ.

One case that will lead to concavity of the α and ξ functions, and so to *status quo* bias, arises when the only source of variation in the common law system is it's response to new legislation. In this case the distribution $H_q(\tilde{r}, \rho, \rho)$ would be degenerate, placing all it's weight on a single point, call it $r(\rho)$. Normalizing the legislator's policy instrument so that $r'(\rho) > 0$, so that increasing ρ means raising the quality level, we have:

$$\alpha(\rho) = \int (\beta u(r) - (1-\beta)e(r))\, dH_q(\tilde{r}, \rho, \rho)$$
$$= (\beta u(r(\rho)) - (1-\beta)e(r(\rho)))$$

and hence:

$$\alpha'(\rho) = (\beta u'(r(\rho)) - (1-\beta)e'(r(\rho)))\, r'(\rho)$$

Similarly, adopting the convention that $q(\gamma)$ is an increasing function of γ, we would have:

$$\xi'(\gamma) = ((1-\beta)v'(q(\gamma)) - \beta c'(q(\gamma)))\, q'(\gamma)$$

Substituting these expressions into (6) and (7) and rearranging terms we see that a legislature facing common law courts will choose γ and ρ to satisfy:

$$u'(r(\rho)) = \frac{(1-\beta)}{\beta} e'(r(\rho)) - \frac{\omega_\rho(\rho_L, \rho_0)}{\beta r'(\rho)} \tag{8}$$

and:

$$v'(q(\gamma)) = \frac{\beta}{1-\beta} c'(q(\gamma)) - \frac{\psi_\gamma(\gamma L, \gamma_0)}{(1-\beta)q'(\gamma)} \tag{9}$$

These conditions facilitate comparison with the choices made by a legislator whose policies will be implemented by civil law courts, about which there is no uncertainty, see equations 3 and 4. The conditions for the common law system are identical with those for its civil law counterpart, save that equations (8) and (9) each contain an extra term that pushes the choice of policy instrument in the direction of the *status quo*. The prospect of enforcement by common law courts will induce the legislator to implement quality thresholds that lie between their civil law counterparts and the *status quo*.

By itself this does not establish that the $\tilde{q}$ and $\tilde{r}$ will be closer to their Pareto Optimal levels q^* and r^*. This depends as well on the location of the *status quo* policy, and on the "overhead cost" of idiosyncratic rulings by the common law courts. If this idiosyncrasy is really the result of the common

law courts reconciling the letter of the law with the "justice" of the case, then the heterogeneity of implementation is an advantage, at least if it can be anticipated by the parties to a contract at the moment they choose quality levels. On the other hand, if the common law courts simply impose the quirky opinions of individual judges, then this heterogeneity will act as a cost against which any tendency for the common law courts to keep policy closer to the Pareto frontier would have to be weighed. Yet, even in this pessimistic case for the common law courts, if the costs of unpredictable implementation of new legislation, represented by the ω and ψ functions, rise sufficiently rapidly as policy moves away from the *status quo*, they will curb the legislature's incentives to modify the *status quo* quickly, before the total costs of the common law policy outcome exceed those of the administratively efficient implementation of economically inefficient laws written by a legislature that anticipates civil law enforcement.

Whether the *status quo* bias in common law enforcement helps or hinders economic activity also depends on the location of the *status quo*. One can just as easily imagine the common law courts entrenching inefficient economic regulations as efficient ones. Indeed, it was in part because of their experiences with corrupt common law courts that the French implemented the Napoleonic Code, which epitomizes the civil law emphasis on certainty (Merryman., 1969).

However, if we imagine a political system in which the fortunes of the various economic sectors wax and wane with the electoral tides, then we might expect the *status quo* at any time to lie somewhere between the policies preferred by one sector or another. In this case, the *status quo* bias of the common law system would dampen the tendency for the faction that enjoyed a temporary majority in the legislature to modify policy in the direction of their support group.

A Comparison with Other Literature

While much of the literature comparing civil law and common law countries emphasizes the close linkage between the legal system and culture, some authors go beyond the circularity of arguing that societies using the civil law courts "are the way they are because that's the way they are" to seek cause and effect relationships between the details of civil law and common law enforcement on the one hand, and economic outcomes on the other. Dewatripont and Tirole. (1999) use game theoretic analysis to compare the relative merits of adversarial common law jurisprudence and the more inquisitorial approach of the civil law judiciary.

Glaeser and Schleifer. (2000) are more explicitly interested in the linkage between the choice of legal system and economic outcomes. They contend that countries choice between civil law and common law systems is influenced by the relative costs of bullying by powerful local magnates (best resisted by civil law courts) and oppression by a strong central government (against which the common law courts are asserted to provide the best defense)[7]. Glaeser and Schleifer's argument suggests an important role for selection in producing the observed result that common law countries enjoy higher growth rates, because countries that are easier to govern are best served by common law enforcement, while hard to govern countries may be better off (at least in the short run) with civil law enforcement.

Glaeser and Schleifer do qualify this benign diagnosis somewhat. First they note that as the role of government expands and local bullies are brought

[7]Glaeser and Schleifer make an extended and interesting argument that the differences between the civil law and common law traditions reflect differences between England and France stretching back as far as the Twelfth Century. This interpretation contrasts with the view that the Napoleonic Code represented a sharp break from with France's pre-revolutionary past, and that an important reason for the civil law system's resistance to judicial discretion stemmed from abuses in the common law courts of pre-revolutionary France (Merryman., 1969). Of course, others have emphasized the degree to which the French Revolution was not a new beginning, and actually continued and even intensified trends that had already existed (Tocqueville". (1983), Furet. (1995)). While the pedigree of the differences between English common law and the civil law tradition of France is of independent interest, it is not essential to Glaeser and Schleifer's central assertion that the relative success of civil and common law systems hinges on the balance of threats between local bullies and the central government.

under control, countries may be better off switching to common law enforcement, or pay a price in reduced economic growth if they do not. Glaeser and Schleifer also note that detailed civil codes adapted to France or Germany will in some respects be poorly tailored to the needs of developing countries, while common law judges and juries may be better suited to adapt the letter of the law to local needs. Nevertheless, the policy implications of their theory are mostly an assertion that only little can be done to affect the *status quo*: the civil law countries are asserted to grow more slowly because of local governability problems, and civil law, far from contributing to the problem, is a part of the solution. From this perspective the civil law courts are to low growth what blood pressure medication is to heart disease. While we want to be careful to monitor the patient's continued need for treatment, and while it is not advisable to start taking the colonial power's left over medicine without a prescription, common law accords no general growth promoting advantage over civil law.

The policy implications of the analysis in this paper stand in sharp contrast with the *laissez faire* implications of the Glaeser and Schleifer model. If it is the very efficiency of civil law enforcement that tempts the legislator to intervene with politically expedient but economically inefficient legislation, then civil law enforcement will inevitably invite the more invasive regulation we see associated with it. Moreover the prediction that it is judicial discretion that curbs the legislator's appetite for regulation is consistent with the observation that countries using the German version of civil law, with its greater emphasis on the "rule of reason" enjoy better economic performance, and better legal protection for *both* investors and creditors than do countries using more constrained French-style civil law (La Porta et al., 1998).

Conclusion

This paper develops a simple theoretical model that illustrates the potential for the very unwieldiness of common law enforcement to curb legislators willingness to use economically inefficient regulation to transfer rents to their constituents. This curbing effect is caused by the unpredictability of the common law courts' response to newly written legislation. This unpredictability leads a *status quo* bias as legislators change policy by less than they would if they could count on efficient and transparent enforcement of by civil law courts. While *status quo* bias is not always benign, it will tend to lead to outcomes closer to the Pareto Optimum when the alternation in power of political parties has left the *status quo* at a more moderate point than the regulatory extremes that would result if the legislature could directly implement it's will.

The prediction of this model, that judicial systems which favor clarity in the enforcement of the laws will produce less efficient economic outcomes than systems that provide more leeway to individual judges to interpret the laws, is consistent with the general empirical finding that the English Common Law countries, with high levels of judicial discretion, enjoy more economic growth and have better commercial laws than those using German and Scandinavian Law, where judges have a more intermediate level of discretion in enforcement, while countries influenced by the French civil code, which most faithfully carry out the will of the legislature are found to fare the worst (La Porta et al., 1998). According to the model set forth here, the very effectiveness with which the civil law courts carry out the will of the legislature creates a greater political temptation to use inefficient regulatory policy to transfer rents.

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