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COMPARATIVE LAW AND ECONOMICS

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Abstract

This chapter aims at providing a definition of this rather new subject, which is situated at the crossroads of two different scholarly traditions, comparative law and economic analysis of the law. Comparative law and economics combines the instruments and methodologies of both these two disciplines because in this way it is possible to better understand the reasons of existing legal rules and institutions and of their evolution. It uses a dynamic approach to law, by focusing on the study of phenomena of legal divergence and convergence. These phenomena may take place within a single legal system, and in this case the analysis of legal formants (a technique created by comparative law) provides the analytical tool for verifying the law in action, which may be hidden behind different formal rules. Interaction may also happen among different legal systems, and we term this latter phenomenon 'legal transplant', which can take place for single rules or institutions or for entire branches of law, and can be determined by different reasons which range from prestige to forced imposition. Economic analysis of law provides further analytical tools that help measure the level and entity of analogy or divergence. Beside the traditional tools of neoclassical economics, useful insights may be gained through the instruments of the new institutional economics, particularly path-dependence, which, through the analysis of the relationship between formal and informal institutions, and of these with organizations, opens new lines of interpretation of legal change.

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1. What is Comparative Law and Economics?

Comparative law and law and economics are well-established legal specialties. The two disciplines may benefit from each other, both having a strong non-state-centric approach to legal analysis. Specifically, comparative law may gain theoretical perspective by using the kind of functional analysis employed in economic analysis of law. Comparative law may proceed a step forward in its target of measuring and understanding analogies and differences among

alternative legal patterns by using the tools of what is considered by many scholars the most theoretically advanced social science (Cooter, 1982).

Traditional law and economics is clearly an American product. One of the first applications of comparative law and economics is therefore the translation of such a paradigm to different institutional settings, not only the civil law Mattei and Pardolesi (1991) but also outside of the Western legal tradition (Bussani and Mattei, 1997).

Several factors attest to the existence of an intellectual environment favorable to the reception of law and economics outside the USA: the increasing interest of civilian legal culture for the common law experience and, particularly, for American law (Cooter and Gordley, 1991). This growing interest is due to a multiplicity of factors, the most obvious being the widespread diffusion of the English language which allows access to common law sources; and the appeal of American universities to younger generations of scholars; the introduction by means of the mass media of American cultural models. More generally, it is globalization in the sense of a process of Americanization of the worldwide legal culture that calls for a less parochial approach to the economic analysis of the law.

Within such a favorable environment, law and economics not only comes from the 'right' place but throws in the market of legal ideas all the tremendous prestige of economics, which many scholars regard as the leading social science. Nevertheless, European scholars have not been able so far to develop a European style of law and economics capable of competing in quality with the American one. American intellectual leadership has been complete. The reason for this shortcoming is to be detected in the lack of comparative skills. So far in Europe, the alliance between law and economics on which the very strength of economic analysis of law is grounded has largely failed, and the economic approach has been used more by the lawyers than by the economists (Kirchner, 1991; Finsinger, Hoehn and Pototsching, 1991). Moreover, many lawyers using it are remarkably unaware of the structural nature of their own institutional setting when approached in a comparative perspective (Kirchner, 1991).

Law and economics can be used to build efficient models, which work as uniform terms of comparison for the concrete solutions of the legal institutions analyzed. Such models, although they may introduce unrealistic assumptions (such as zero transaction costs) should be complex enough as not to be simplistic, and may eventually allow the proper measurement of the distance that separates the efficient model from each of the real-world legal system to which it is compared. In such a way the analysis can be completely factual (Cooter and Ulen, 1988).

Since economic models may be used to measure the real impact of a given set of legal signals on the market actors (Prichard, 1988), comparative law and economics, by comparing the law of alternative legal systems with the

'efficient' model offered by economics, conveys the possibility to measure the core of legal system (Schlesinger, 1969), that is the actual analogy (or difference) of the signals they convey to market actors, the assumption being that equal signals will provide similar incentives.

On the other hand, nowadays a strong case is made for the rebirth of 'legal process-style' comparison of alternative legal institutions (Rubin, 1996, p. 1394; Hart and Sachs, 1994). Comparative law may offer to economic analysis a reservoir of institutional alternatives not merely theoretical, but actually tested by legal history (Komesar, 1994; Palmer, 1995). The contribution of comparative law looks particularly promising to law and economics which, until recently, has suffered from a severe American-centric provincialism.

Comparative law and economics is a positive discipline which - from the standpoint of efficiency - 'deals with the transplants that have been made, why and how they were made, and the lessons to be learned from this' (Watson, 1978b, p. 318). Comparative law and economics, on the other hand, may also be considered a practical study which - again from the efficiency point of view - 'deals with the transplants which are appropriate and how they should and can be made' (Watson, 1978b, p. 319). In the language common among law and economics scholars, there may be both a positive and a normative version of comparative law and economics.

1.1 Static and Dynamic Comparative Research

'Comparative law presupposes the existence of a plurality of legal rules and institutions. It studies them in order to establish to what extent they are identical or different' (Sacco, 1991, p. 5).

The comparative analysis of different legal systems shows that there is a need to distinguish between what can be called the 'working rule' and the legal justification given for the application of this rule. The analysis of 'legal formants', that is the different formative elements of a legal rule, has the aim to discover how the 'jurist concerned with the law within a single country examines all of these elements and then eliminates the complications that arise from their multiplicity to arrive at one *working rule*' (Sacco, 1991, p. 22, italics added; Monateri and Sacco, 1998).

Let us consider only two elements involved in a comparative analysis of legal systems: the working rule, that is the rule applied in a given case (traditionally known as law in action) and the legal justifications that are needed in the system to ground the application of this rule. For example: if a patient has suffered damage because of a wrong cure prescribed by a physician we will find, for instance in the USA and in Italy, that the latter must pay to the former a sum of money to restore his loss. But in the USA the judge will find a breach of a duty of care, whereas in Italy a different judge will find a violation

of the constitutional right to health, granted by article 32 of the Italian Constitution. The outcome of the case is similar, but the legal justifications for it differ.

Comparative law can be approached within two paradigms: the static and the dynamic analysis. The former is concerned with the comparison of a set of legal formants in two or more legal systems at a given time: it tries to identify differences and analogies within the realm of each legal formants and to understand how each of them contributes in framing the working rule.

Dynamic analysis tries to give account of the mutual interactions between legal systems in the course of history and mainly focuses on legal change.

Given the aim of this entry we will focus mainly on dynamic analysis. The possible result of such an approach can be categorized as follows:

- (1) convergence: legal systems starting from different points tend to converge toward similar solutions;
- (2) divergence: legal systems moving from similar starting points tend, in the course of time, to reach different legal solutions.

2. Convergence and its Explanations

In comparative law jargon, 'convergence' is defined as the phenomenon of similar solutions reached by different legal systems from different points of departure. Such a convergence may be explained by using both legal transplants and economic efficiency. The general convergence of modern legal systems, despite the large variety of institutional backgrounds, could be explained as a movement towards efficiency. In this case there seem to be a synergy between the efficient model and the prestigious model. Efficiency may be used to evaluate legal transplants. The framing of legal rules may be explained as the outcome of a competitive process. (Mattei, 1997a).

Many different inputs enter what we may call the market of legal culture. Within this market the suppliers meet the needs of the consumers. This process of competition would determine the survival of the most efficient legal doctrine at zero transaction costs. Nevertheless, there are several difficult problems that we must face in order to prevent this simple model from becoming overly simplistic. First, we must consider that in the market of legal culture, suppliers and consumers may be the same. Secondly, the so-called legal tradition, or worse, legal parochialism, may unduly restrict the market and result in failures.

2.1 Legal Transplants

Comparative law has reached an important conclusion in its more recent and sophisticated developments. In most cases, changes in a legal system are due to legal transplants. 'The moving of a rule or a system of law from one country to another' has now been shown to be the most fertile source of legal development since 'most changes in most systems are the result of borrowing' (Watson, 1974, p. 20). Comparative lawyers have been prolific in amassing evidence for this somewhat paradoxical conclusion. Each single legal transplant has its own peculiarities, which make it different from every other. It can be more or less general; more or less confined to a superficial level of the legal system (Watson, 1995).

The attempts to explain legal transplants from one system to another have relied on the largely empty idea of 'prestige'. This shortcoming is due to the fact that comparativists who have been working on legal transplants are less interested in a theoretical explanation of why a legal borrowing happens than in observing its occurrence.

If a transplant happens in a competitive scenario, it is likely that the transplanted rule or doctrine is more efficient than other possible alternatives. Conversely, one could argue that if a doctrine enjoys wide success in the competitive arena of international legal thinking and practice this means that it is more efficient than its alternatives (Mattei, 1994a, 1995a).

In spite of this, the existence of divergences in different legal systems does not mean inefficiency. Indeed, if there is a *prima facie* case for the efficiency of a legal doctrine on which there is a large agreement within the competitive market of legal theory and practice (Hirsch, 1981), this does not mean that there is just one legal rule efficient for each legal problem. Different legal traditions may develop alternative solutions for the same legal problem which are neutral from the standpoint of efficiency (Rose-Ackerman, 1995).

In many areas of the law, we may find legal change and eventual convergence due to a tendency towards efficiency, which has nothing to do with the so-called prestige of the legal model on which convergence is eventually reached. In the areas of the law where important efficiency concerns are at stake, comparative law and economics can play a crucial role in legal improvement. In its normative dimension it may work as a prestigious support to non-prestigious legal systems which have already reached the efficient solution without having the internal strengths to export it. In its positive dimension it helps to detect these phenomena at work. By using the tools of the comparativists together with those of lawyer's economists we may be able to see if an institutional arrangement, a legal doctrine, or a legal rule of one legal system is more or less efficient than another. We may detect and explain the phenomena of convergence. We may identify those aspects of a given legal system that stand in the way of the reception of an efficient solution. We may

be able to foresee long-term efficiency consequences of a given legal arrangement that are impossible to identify if we do not employ comparative methods. By using the comparative approach we can even find a workable answer to the question of what is efficiency. From the point of view of a given legal system, efficient is whatever avoids waste; whatever makes the legal system work better by lowering transaction costs; whatever is considered better by the consumers in the legal marketplace; whatever, in other words, does not pointlessly foreclose the development of a better organized human society; whatever legal arrangement 'they' have that 'we' wish to have because by having it they are better off.

2.2 The Competitive Relationship among Legal Formants

Another explanation of the convergence toward efficiency can be competition among legal formants.

Competition and equilibrium among market actors may well be the key to understanding economics (Stigler, 1987). This concept, however, is virtually unknown to modern lawyers, who presume that the country in which they live has a monopoly on the production of law. Comparative law strikes a hard blow to this view by pointing out the degree to which legal issues are not restrained by national boundaries. Law and economics scholars, who view legal rules as a system of incentives (or implicit prices) rather than as a set of rules enforced by the State, also challenge legal positivism. It is in the area of sources of law that these two non-state-centered approaches seem to better complement one another. Accordingly, a competitive model can accurately describe the relationship between the so-called sources of law (Mattei and Pulletini, 1991). Comparative law and economics considers the law as the product of a competitive process whose outcome may be determined by structural (that is institutional and cultural) constraints of decision making (Cooter and Drexler, 1994; Ulen, 1996). Of course, such constraints, and therefore the outcome of the competition, may well vary from system to system, conferring to different legal formants different degree of authority.

Two major legal theories have developed in Western jurisprudence, which provide conflicting paradigms of legal scholarship: naturalism and positivism. These paradigms, although antithetical, share a common idea, which has remained unchallenged until quite recently. This idea, reinforced by legal positivism, may be referred to most simply as 'the unitary theory of the legal rule'. This theory can be described in terms of a model of hierarchical co-operation: the legislature drafts laws which are applied by courts to concrete situations, possibly with the aid of books and articles written by law professors (Sacco, 1991, 1992b). Of course there may be alternative approaches, as in common law systems. In such an approach the legal rule may be created (or derived) by the courts, again with the cooperation of scholars (or of other

courts' precedents) and with the acquiescence of the otherwise powerful legislature.

Lawyers, therefore, had to establish a hierarchy of sources of law to resolve conflicts among them. The assumption was that, once ranked, sources of law would cooperate with each other to provide coherent, unitary legal messages to the community. The basic assumptions of the unitary theory of the law are still shared by the majority of lawyers in both civil and common law systems and are reflected in their terminology and in their disputes.

In recent times, some scholars have developed a theory which, taking into account the transnational nature of law, criticizes the unitary theory of its sources. According to this alternative theory, based on a clear distinction between law and legislation, the legal rule is the result of the interaction of different components, also referred to as 'legal formants' or formative elements (Sacco, 1991).

A legal formant is any legal proposition that affects the solution of a legal problem. For example, rules contained in the writings of legal scholars are legal formants, as well as rules contained in judicial decisions or statutory provisions. Also *obiter dicta*, insofar as they affect the solution of legal problems, may also be considered 'legal formants'. So, too, can administrative regulations, constitutional provisions and even broad definitions contained in codes. Legal propositions that do not contain rules but only definitions or broadly stated principles are legal formants, too. Legal formants, as sources of law, do not have to be (as in traditional theory) mutually coherent, even within the 'professional groups' that elaborate them (scholars, judges, legislators) (Van Caenegem, 1987). Scholars, judges, and legislators represent producers who offer their products (different legal rules conceived to regulate a given relationship) in a more or less competitive market.

Historically, legal systems develop in tremendously complex ways. There are different sets of legal rules not only addressed to different subjects (for example a law for merchants and a law for consumers), but also to the same subject as a result of different transactions (for example administrative agency in its public law v. its private law capacity). This is the product of rather independent, and often competing, legal systems coexisting within the same territory (suffice it to think about arbitration). Legal pluralism is the rule rather than the exception, even after the rise of the modern State. Similar problems of complexity are reinforced because of the multinational interaction of different national legal systems.

Comparative law and economics goes further along this line, addressing the relationship between different formative elements which make any legal rule. Competition rather than hierarchy captures this relationship between sources of authority. Competition is at play either among different legal orders, as among members of the European Union to devise rules of European law or

to attract forum shoppers, or between different sources of the law within a given system (Reich, 1992; Antonioli, 1995, 1996). Of course, these two main patterns do not exclude one another. Applied law is the outcome of a competitive process between 'legal formants'. More generally, law is the synthesis both of exogenous factors, determined by culture, economic structure, and political system, and of endogenous elements. The works of the Austrian school, particularly Hayek's concept of competition with its emphasis on the working of the competitive process rather than the characteristics of competitive equilibrium, is appropriate to describe the formation of the legal rule (Hayek, 1973). From his theory of knowledge, Hayek formulates one of his more fundamental criticisms of perfect competition: knowledge and information, rather than being the basis for, are the *results* of the competitive process. This reverses the causal relationship assumed by traditional economic theory.

Considering the sources of law in competition with each other despite the official hierarchy does not lead us to assume a jurisprudence of 'hunches' due to the staggering variety of the possible outcomes of the competitive process and to the impossibility to predict which legal formant will actually 'win'. Indeed, the result of competition is not less predictable than that of cooperation. It is only more realistic.

Does competition lead to efficient law? It is tempting to conclude that in the long run, within a group of cases, a legal trend may be foreseen as a result of a 'spontaneous order'. It would be even more tempting to say that an 'invisible hand' leads one efficient rule to triumph over all others. Unfortunately, the mentioned complexity of legal systems does not allow us to reach these conclusions (Mattei, 1994a). While in the world of zero transaction costs such evolution towards efficiency could be expected, this is not the case in the real world where institutional and cultural constraints introduce high transaction costs.

2.3 *Why Efficiency?*

Equity and efficiency are usually perceived as antithetical concepts. An efficient legal solution may not be equitable and an equitable one may not be efficient. Many of the arguments used against law and economics sound like this: law should be concerned with justice and equity; although values may not be costless for a society, lawyers should not be concerned when their pursuit is inefficient.

Comparative law and economics allows us rather original insights on the matter. In using the tools of law and economics together with those of comparative law, the notion of efficiency assumes itself a comparative meaning. An institution, rule or state of the world is never efficient or inefficient in an abstract or absolute way. It may only be so compared with concrete alternatives that may fit better or worse to a given context. The alternative rules, institutions

or state of the world may be provided by history, by comparative analysis or by scholarly creativity. Consequently, the notion of efficiency, as used in comparative law and economics, maintains a clearly dynamic meaning, strictly linked with the notion of legal change.

Law is not something that can be understood (as it is usually done in traditional law and economics) as an aggregate of legal rules. It is a much more complex phenomenon that can be understood only by considering a variety of different levels in which a legal proposition appears.

Lawyers are part of the legal system in which they operate in whatever professional capacity they may act in it. When they describe the law, their interpretation is part of the law that they are describing. Law has an important practical dimension. Since the beginning of the Western legal tradition lawyers have been arguing whether law should be more of a theoretical doctrinal enterprise or just a practical business. We can trace this debate to the reaction of the humanists to the bartolists in the fifteenth century (Cannata and Gambaro, 1989). Indeed, the role of lawyers in the Western world can be understood in terms of the continuous interplay of these two different approaches (Berman, 1983). The commitment to doctrine and theory has been the major source of lawyers' legitimacy: they were able to claim they had a neutral approach to problem-solving. The practical aspect of lawyers' work has made them a powerful and influential corporation of hidden law-givers. Since law has a practical dimension it requires an approach somewhat different from that of a purely academic discipline (Gambaro, 1983).

In order to maintain their role in framing legal rules and institutions, lawyers had to find some reason why their opinions about the rules that govern society should count more than anybody else's. They had to legitimize their work. For 900 years, whenever they could not or would not rely on a 'text', they played with the philosophical concepts of equity and justice. In using these concepts, however, they were not worried by or even aware of the many different theoretical notions of equity and justice framed by legal philosophers.

If equity is traditionally a category of legal argument, the same cannot be said for efficiency, which has been marketed only recently as an American product. Seen in terms of the history of ideas, law and economics has grown to be a powerful approach because the discipline has given some strength to the claim that legal scholarship is a science. Indeed, the shift from equity to efficiency brings to the analysis of the law a set of value judgments, which is claimed to be more widely acceptable and less subjective in nature.

The change of focus proposed by law and economics goes right to the heart of the legal discourse. Its agenda is as simple as it is revolutionary: rather than focusing on justice, legal analysis should focus on efficiency. Efficiency should become the key of legal interpretation (Symposium, 1980). Borrowing from the expertise of welfare economics, the economic analysis of law puts the legal

discourse through a number of other gyrations: law should not be analyzed as a system of coercion, but as a system of incentives or as a system of implicit pricing. Legal interpretation should not be guided by justice; it should be guided by efficiency (Cooter, 1989). Consequently, lawyers - as opposed to legislators-politicians - should not be concerned with dividing the pie as much as with making it bigger. Their role is not that of helping to cut the slices in a more just way. Issues of distribution should stay outside of the scholarly analysis of lawyers. They are the domain of politics.

Justice is a 'subjective' value, while efficiency is 'objective'. Indeed, there are only a couple of notions of efficiency accepted by the established economic paradigm (Pareto and Kaldor Hicks) and there are as many notions of justice as judging individuals. Reduced to the minimum possible level of value judgment, the efficiency criterion requires lawyers to act in a way that avoids the waste of resources (Mattei, 1994b).

It is easy to observe that the success of law and economics lies in one fundamental epistemological assumption that it has borrowed from economic theory. This assumption is the difference between the world of the *is* and the world of the *ought*, the fact and the value, the positive and the normative levels of the scholarly discourse (Polinsky, 1989; Posner, 1992).

We should first clarify that the word 'positivism' has a number of different meanings (Hovenkamp, 1990). Simplifying the sense more common among lawyers, in which we will use this notion, positivism equates the legal system to what is positive law (that is, binding law) within a given legal order. In this sense, it becomes a State-centric approach to the law, and both law and economics and comparative law can well be considered non-positivistic approaches. Another meaning - that should not be confused with the former, although it shares with it some of the same epistemological assumptions - can be considered fundamental to the very existence of the economic science: in this meaning 'positivism' refers to the paradigm of research that distinguishes between the *is* and the *ought*.

Economics gives to lawyers, with the distinction between the world of the *is* and the world of the *ought*, the possibility of a two steps interpretation, of a more detached look to the legal system. The same is true, and often claimed, of comparative law (Sacco and Gambaro, 1996).

3. Divergence: How to Compare Differences

3.1 The Theory of Property Rights: Rights and Remedies

In order to understand the divergence of legal systems we need some instruments to compare rules and rights that are expressed in different terms

in different legal systems. The theory of property rights is usually perceived as a very useful tool in carrying out this task.

A system of property rights is a 'method of assigning to particular individuals the 'authority' to select, for specified goods, any use from an unprohibited class of uses' (Alchian, 1965; Eggertsson, 1990, p. 33).

The literature on the subject usually indicates three categories of property rights: (1) the right to use, transfer or destroy an asset; (2) the right to contract over and gain from an asset; (3) the right to transfer it (Eggertsson, 1990, p. 34).

What gives effect to rights and their consequent desirability and value, are concrete remedial devices (Levmore and Stuntz, 1990). The remedial approach is therefore recommended by comparative law and economics as potentially capable of introducing a degree of measurement to comparative law (Mattei, 1987). Moreover, there is now a sense within the comparativists' community that while the form of the law (in the broad sense of the style of the legal system) is very diversified, its substance may show remarkable phenomena of convergence, at least among systems belonging to the Western legal tradition (LoPucki and Triantis, 1994).

Remedies give value to substantive rights. Each individual is therefore interested in being protected by certain remedies. As only remedies may grant the feasibility of a certain course of action, they may not be granted contemporaneously to conflicting self-interested individuals on the same scarce resource (Levy and Spiller, 1994). One of the two individuals must prevail, and therefore be entitled to a stronger remedy. Accordingly, legal remedies may be analyzed as a scarce resource whose value is a function of that of the resource they permit someone to enjoy.

Different legal systems allocate different bundles of remedies differently when faced with conflicts over scarce resources. The subjective desirability of different combinations of remedies allows for a ranking of different 'property rights' which courts may handle in dealing with externality problems. This degree is a function of the structure of legal remedies supplied by different legal systems, and it is by no means constant. Remedies may be combined among themselves in a large variety of patterns and may be given to protect varying degrees of right-holders' autonomy on the use of different resources (Calabresi and Melamed, 1972; Kaplow and Shavell, 1996). Each legal system (or legal tradition) chooses according to its values (and to the structure of its decisionmakers), which rights are to be valued more and protected as such. Other interests are valued less, and can be redistributed *ex post* by the courts.

In every modern legal experience property rights, in their different forms, carry liabilities with them. Given these liabilities, property rights are not, as a matter of principle, less socially valuable than regulation. The intellectual challenge is to construct a theoretical model of property rights able to take into account this complexity (Mattei, 1997a).

Injunctions (or equivalent remedies such as ostracism or criminal sanctions) are always symptoms of the unlawfulness of the course of action which they enjoin. When there is no injunction, the internalization of the costs of an action is compatible both with lawfulness and with unlawfulness of the course of action, which creates the externality. In other words, it is compatible with any distribution of property rights. Liability rules, on the other hand, are nothing more than an insurance for the entitled share of social welfare. They protect an interest, not a right.

3.2 Property Rights, Liability Rules and the Theory of Transactions Costs

By discussing the historical and comparative law roots of the notion of property rights used in the economic analysis of law (Alchian, 1987), one can examine what may be regarded as the most important difference between comparative law and economics and traditional economic analysis of law. While this approach attempts to account for the different institutional alternatives presented by real-world legal systems, law and economics elaborates its theories on institutional backgrounds which are either abstract natural law models, or which uncritically postulate the modern institutional background of US law (Ajani and Mattei, 1995; Benson, 1989; Benson, 1995).

Comparative law is essentially a historical branch of scholarship which seeks to discern both differences and similarities among alternative legal institutions (Schlesinger, 1988). Its methodology may prove very helpful to law and economics, since it offers a more global perspective on different legal structures and on the evolution of these structure which may shed new light on - and challenge at the same time - certain previously undisputed assumptions of traditional law and economics. As a result, comparative law and economics does not conceive the legal system as a static background for economic analysis able to be captured by a few, never revisited, simplified assumptions. Nor does it assume that the contingencies of the American legal process are the necessary *substratum* for theories concerning the efficiency of law. The legal background represents a dynamic variable which economic analysis of law must reflect in both its positive and in its normative dimension.

The natural law conception of property is an intellectual category which does not exist, and never existed, as 'law in action' in any legal system (Gambaro, Candian and Pozzo, 1992). Using comparative analysis, it is easy to show that applied law only knows more complex forms of property rights based on a mixture of property and liability rules allocated in different ways to different individuals by different institutional agencies in different legal systems (conjunctive property rights).

The idea of property rights which serves as the institutional background for traditional law and economics is that of a bundle of rights that a person has over certain resources. Included in this notion are the enjoyment and

transferability of property, and the power to exclude others from it (Demsetz, 1967; Pejovich, 1990). Comparative law and economics questions such assumptions by showing that, due to a historical paradox, law and economics is based on a substantive natural law conception of property rights. This conception, developed by the civil law tradition, was never fully accepted by the common law, and was eventually abandoned by lawyers across the entire Western legal tradition.

Law and economics has maintained the natural law misconception of property. How did this happen? In the cultural milieu of the United States in the 1960s, scholarship was ripe for the merger between law and economics. American lawyers, eager again to use broad theoretical categories, decided to borrow them from economists. Consequently, simplified legal notions that economists have not rediscussed since Adam Smith found their way into legal scholarship. Rather than working within a genuine interdisciplinary effort to develop new legal categories able to reflect the complexity of the institutional system, law and economics borrowed a number of naturalistic legal models. Such models are not only simplistic and unrealistic but also foreign to American common law tradition (Mattei, 1997a)

These assumptions should not be considered necessary components of law and economics. They are the product of accident in the evolution of a scholarly tradition and should be analyzed as such. Comparative law shows that the substantive structure of property rights varies from one legal system to another and never follow the natural law model. Such unawareness may, however, prove dangerous. Comparative law and economics develops the Coasian paradigm by analyzing real-world legal institutions as alternative ways of allocating unavoidable transaction costs.

The notion of property rights suggested by comparative law and economics is at once non-naturalistic and non-positivistic. While it breaks with the former conception, it does not go to the opposite extreme of confining itself within the narrow and contingent boundaries of a single positivist legal system. Taking the comparative approach means offering notions that may be used to understand different patterns of legal organization (Ramseyer, 1989).

Since Coase (1988), we have full knowledge of two alternative models of institutional control of externalities: the Pigouvian model, based on centralized regulations, and the Coasian decentralized model, based on the enforcement of property rights by the courts (Benson, 1991a). Any theory of property rights must take into account the following central point: in the real world there cannot exist a system that deals with externalities using a purely decentralized approach; similarly, there cannot exist a system which deals with externalities in a totally centralized Pigouvian way. This is the consequence of the impossibility of the pure market, as well as of the opposite impossibility of the absence of a market. Property rights and regulation, therefore, serve the same purpose. Their placement in an antithetical structure, an assumption of lawyers, economists, and the law and economics movement, is false (Williamson, 1991).

After Coase, the problem which deserves attention is the allocation of transaction costs which are part of the real world. This allocation is the key to understanding the problem of externalities and to elaborate a realistic conception of property rights. From Coase onward we know that a well-defined system of property rights will take care of externalities because individuals will bargain to reach an efficient result. This wonderful achievement of the Coase theorem has encouraged widespread efforts to use property rights to solve problems of externalities in a variety of situations (Laffont, 1987). The exercise of natural law property rights may impose external costs upon others. Restraints upon these rights are needed to control them. Under the conjunctive conception, obligations, which are needed to restrain external costs, are part of the very idea of property. Consequently, controls upon externalities need not be imposed in opposition to property rights, but may be introduced *ex ante* in the distribution of property rights.

4. An Exercise in Comparative Law and Economics: the Distinction Between Common Law and Civil Law

The lack of comparative understanding within the legal community has created a two-fold problem for law and economics. American law and economics has been remarkably parochial, unable to question the presumed need and immutability of a legal process patterned after the American one. Traditionally, law and economics contributions tend to presume a court system and, more generally, a legal process organized on the American style.

In Europe, the same lack of comparative understanding has prevented committed law and economics scholars from developing original insights capable of shedding new light on the civilian legal process (Mattei and Pardolesi, 1991). Many civilian law and economics scholars have uncritically applied theories which only work in the American scenario to the different background of their legal systems.

More generally, the widespread legal parochialism on both sides of the Atlantic has precluded a distinction between institutional arrangements which are local contingencies incapable of generalization, and deeper levels of legal analysis that can be used in understanding *the law* as a general phenomenon of social organization. The same lack of comparative understanding has, moreover, fueled the false impression that, because of the structure of the civil law tradition, law and economics is less useful as a tool of analysis in Europe than in the United States. The attempt to build models which reflect the complexities of the real world of the law is exactly what comparative law and

economics is all about.

The misconception that lawyers introduce into traditional economic analysis of the law may be called the municipal misconception. This misconception stems from the other leading paradigm of jurisprudence in Western law: legal positivism. This is odd, because law and economics may be considered *per se* a remarkably anti-positivistic approach. Lawyers, however, can hardly resist focusing on the legal system they know best (that is, the legal system in which they operate and where they received their legal education). Certain basic institutional arrangements of the legal systems are just presumed to be natural and are never questioned by lawyers trained in that legal system.

Legal positivism equates law with the legal production of the state. Consequently, in its understanding, law exists only as a function of the enforcement mechanisms behind it. This approach is rejected by comparative lawyers who consider a legal problem the same wherever it has to be solved, and the alternative legal systems as possible variables for its solution. It is, however, followed more or less consciously by the majority of lawyers across the legal traditions. Positivism is considered a reaction to natural law. From the perspective of parochialism, however, they push in the same direction.

It is crucial for comparative law and economics to get rid of both of these sets of mute assumptions in order to develop its scholarly paradigm. Indeed, comparative law and economics is neither naturalistic nor positivistic, but struggles to re-introduce a measure of experimentation into the social sciences by comparing the different solutions of legal and social problems adopted in different legal systems. Because of different institutional arrangements and high transaction costs imposed on legal change by legal tradition, the fundamental distribution of powers and the way in which institutional roles are performed in the legal systems cannot be taken for granted either (Damaska, 1986; Shapiro, 1981).

From the comparative law and economics perspective we can see that transaction costs are introduced not only by alternative substantive rules but by different procedural arrangements, remedial devices, legal ideologies, incentives to litigation, and so on; in other words, by all those characteristics, both cultural and institutional, other than substantive rules, that comparativists call the 'style' of the legal system (Ramseyer, 1995). Consequently, comparing transaction costs imposed in the real world by different legal systems introduces the possibility of a measurement and of a more rigorous comparison than otherwise possible. A path is hence open to compare operative rules (or as it was once said, the law in action) rather than mere theoretical descriptions.

Possibly the most fundamental and discussed question in comparative law is the nature of the distinction between common law and civil law. Certainly a gap exists between common law and civil law; such a gap should neither be exaggerated nor underestimated in nature. Comparative law and economics, by

borrowing its analytical tools from comparative law, accounts for this gap. At the same time, it borrows from law and economics the tools necessary to bridge it.

In approaching the question of the gap, a dynamic perspective on comparative law is needed (Calabresi, 1982). As a result, we will assume that the dimension of the gap is not fixed, but rather varies in both time and space. Deep structural differences are not, of course, a differently worded statute or regulation, or a supposedly different formalistic reasoning of the courts. Relevant legal process differences include: the way of acquiring information in the legislative process; the different role of public law; structural regulation of class actions; the presence or absence of a jury in the fact-finding process; the completely different system of incentives to sue due to different distribution of the costs of litigation; and the different ways in which courts acquire information (Stein, 1984).

From the timing perspective, the comparative law community agrees that the division between common law and civil law is rooted in the early development of centralized courts of law in England and of academic legal training on the Continent (Baker, 1990). There is also general agreement that, after a peak in the course of the nineteenth century, when the civilian nations codified national systems of law, the significance of the gap has progressively declined.

One of the major issues of law and economics concerns the role of the judge in finding efficient outcomes for legal disputes. Great emphasis is given to the different role of the judge in the common law *vis-à-vis* the civil law (Eisenberg, 1988; Atiyah, 1987). Consequently, it becomes important to scrutinize such difference to see whether it introduces a fundamental limit to the application of law and economics in the civil law.

According to traditional comparative law doctrine, the civil law is mostly a codified system where the role of bureaucratically recruited judges is to interpret and apply a written body of statutes (David and Brierley, 1985; von Mehren and Gordley, 1977). Common law, conversely, consists mostly of case law where technocratic judges are concerned with finding the applicable rule within the body of law made up of legal precedents. If such is the picture of the differences between the two legal traditions, there is no doubt that law and economics, being mainly concerned with efficient judicial decision making, seems at odds with civil law systems where judges limit themselves to mechanically applying the law contained in written codes. If this picture were correct and the judges' role as decision maker in common law and civil law was so different, indeed allocating them the same decision making powers would be very unwise from a legal process perspective. The traditional image of a civil law bureaucratic judge, whose role is not to decide cases in terms of public policy but of a mere interpreter of the political will contained in a statute (the code), has been a widespread commonplace of comparative misunderstanding.

This image is opposed to that of a common law judge as the hero of a decentralized system of decision making. This contrast is deepened by arguments about the different value of judicial precedents in the two legal families. Other differences which are frequently cited include a radically different role for legal scholarship, which is allegedly much more authoritative in civil law systems than in common law systems; and the encapsulation of civil law in comprehensive codes (Monateri, 1986). In each of these statements there is some truth (Dawson, 1968), of course, but this does not mean that the consequence of such a background is a radically different legal reasoning which would foreclose the reception of efficiency reasoning in the civil law (Zweigert and Kötz, 1987).

In reality, although it may be true that common law judges are more responsive than their civilian colleagues to policy problems, the aforementioned description is dramatically misleading (Salzberger, 1993; Ramseyer, 1994b), being based on a superficial and outdated image of the differences between the civil law and the common law (Cooter and Ginsburg, 1996). If we consider the role of case law, we find more convergence between modern civil law and common law. In practice, courts in civil law countries make law just as much as courts in common law countries (Gordley, 1994).

5. Comparative Law and Economics and Neo-Institutional Economics

A new fruitful perspective in the study of legal change and legal transplants has been opened to comparative law and economics by recent developments of neoinstitutional economics. Particularly, the idea of path-dependence seems to be a very powerful analytical tool for studying and explaining the evolution of legal systems, where all innovation, be it endogenous or the result of a transplant, depends heavily on the existing institutional framework.

Path-dependent systems are those systems that cannot shake off the effects of past events because small events of a random character, especially those occurring early on the path, influence the selection of one or another among the set of stable equilibria. For this reason *ex ante* predictions of outcomes may not be possible, and consequently it is difficult to foresee future changes. In this situation there is a marked distinction between the notion of *ex ante* efficiency and *ex post* efficiency: the final result may not be the most efficient one in a theoretical world, but it may well be the best achievable in the light of the existing constraints. In other terms, lock-in phenomena, characterized by multiple equilibrium processes and dynamic co-ordination games, may yield Pareto inferior outcomes that tend to be stable (David, 1975). This is a typical result for decentralized decision situations, where a large number of individual agents are linked in a social and informational network; therefore, we may use the term 'network externalities'. In a network context every single decision is

taken independently, but the collective behavior is the result of interaction among them. This is also the mechanism at work in the field of social conventions and institutions, where the common knowledge of recurring behavioral patterns directs the decisions of every actor, and therefore it arises expectations on future decisions (Sugden, 1989). The behavioral norm, in its turn, is the result of a chain of small events, and it may well be globally inefficient, especially if the system is numerically small.

Path-dependence shows that the spontaneous evolution of social customs and norms has a great importance in the configuration of historically existing systems and determines their global efficiency (David, 1988). The presence of a network of relationships creates positive feedback mechanisms, since every agent gains by joining a generally shared rule (Arthur, 1988). This mass of a priori beliefs and mutual expectations helps in achieving non-arbitrary solutions in a situation characterized by co-ordination problems, since it channels (in a probabilistic, not deterministic way) behaviors in a predefinite path; precedent, not only in its legal dimension, is an important instrument for decision (Heiner, 1986). In these processes, ideologies (in the sense of commonly shared ideas and values), or 'mentalité' play a very significant role, and therefore any analysis that aims at explaining a social, legal or economic model needs to delve into the dynamics of collective opinion-formation.

The environment in which decisions are taken is crucial, in the sense that it poses constraints and incentives which determine routines of behavior. Those routines lower transaction costs by making choices repetitive, but they also shape reactions to new phenomena, which tend therefore to be path-dependent (Simon, 1986). Ideologies (in the sense of subjective models and theories that explain the world outside) are an important element of every society, since they permit social actors to reach decisions under uncertainty conditions (Hirshleifer, 1987); the bigger the gap between the capacity of choice and the difficulty of picking up one among several alternatives (that is, the complexity of the choice to be made), the greater the role of ideologies, which become key institutions.

Institutions are the rules that govern a society, the ties that define social relationships among people; they shape all kind of exchanges: legal, political, social and economic. Institutions, which can be both formal and informal, reduce uncertainty by defining the range of individual choices, and therefore they reduce transaction costs. Organizations, on the other hand, are all kinds of apparatus, legal, political, social, economic, through which people pursue some kind of shared aims. Organizations work inside a given institutional framework, but at the same time their action influences in a feedback relation the way in which institutions evolve. (North, 1990).

The theory of institutions is based on behavior theory and on transaction costs theory. Transactions costs (Coase, 1960) cover two kinds of costs: those for evaluating the characteristics of the object of the exchange (information and

measurement costs) and those for monitoring and ensuring the implementation of the agreements, that is for protecting rights (implementation costs). Production costs, which are the key concept of microeconomic theory, are the sum of transformation costs and transaction costs. The neoclassical model is modified in order to take into consideration transaction costs, by posing asymmetrical information (Akerlof, 1970) and exchanges that are not instant; it therefore requires mechanisms for ensuring complete and correct implementations of the agreements. Institutions are created in order to limit those transaction costs by devising rules that dictate behaviors and by creating incentives and sanctions that render implementation of agreements easier (as for example the role of property law in determining rights and protecting them). Institutions, in short, create the structure in which exchanges take place (North, 1990); the more complex the exchanges (that is the more we move away from the neoclassical model of perfect markets), the more sophisticated and diversified the institutional framework that regulates them. For instance, contracts are generally multidimensional, not instantaneous and incomplete, with significant measurement costs and implementation costs. In a setting of close personal relationships there will be strong incentives to stick to deals and to perform contracts. In more complex and impersonal contexts those bonds tend to become weaker, and different mechanisms are required to ensure implementation, since the drive to opportunistic behaviors is stronger. In this case, the most efficient solution will be to use a third party that controls the correctness of the behaviors and can intervene with sanctions in case of transgression; this new institution will decrease transaction costs for the bargaining parties, but at the same time it will absorb resources for its own management, thereby creating a new kind of transaction costs. All those feature are typical of the structure of the State, which produces public goods like legal rules and bodies for implementing them (judiciary, administrative agencies, and so on).

Institutional change is the mechanism that explains the history of every society, therefore in order to understand historical change we need to focus on institutions (Braudel, 1977). Changes usually happen in an incremental way, and they can move both in an efficient or an inefficient direction, depending on the pre-existing institutional setting and on the kind of incentives they create; the process, therefore, can be defined as path-dependent. The higher transaction costs and the less complete the available information, the more the outcome of evolution will tend to be inefficient. The incremental process of institutional change is attained by marginal adjustments in response to the variation of relative prices (technology, information costs, input factors, and so on) and/or preferences, and it ensures the continuity of systems in spite of their continuous modification. These variations can be determined both by endogenous and exogenous factors and they may start both from the formal and informal institutions. A change of the informal ones is a dispersed process, whereas the

modification of formal institutions requires a specific activity by organizations, and therefore greater resources. The change of formal rules implies a sequential adaptation of the informal ties that are related to them, and therefore in the short run a situation of disequilibrium arises, which is then solved by a new equilibrium. History also sometimes experiences discontinuous changes as in the case of revolutions, conquests and calamities, but these are rare events; however, after a strong break there follows a phase where all institutions, especially informal ones, adapt to the new situation, thereby restoring, at least partially, continuity with the pre-existing situation (North, 1990).

Organizations act for the attainment of ends inside an existing institutional framework, and thereby they promote institutional change; the institutional structure orients the process of acquiring knowledge and skills, and this trend is the most important factor of a society's long-term development. These activities require the capacity to build knowledge and to transmit it, and knowledge is mutually dependent from ideology since the level of knowledge determines the conception of the outside world, and this in its turn influences the direction of scientific research. The firm is the type of organization that has been most extensively studied by economists; its existence can be explained by transaction costs: the organization reduces uncertainty in the decision process, and thereby reduces costs (Coase, 1937). As for the firm, the rational and maximizing behavior of all kinds of organizations influences institutional change through the demand of investment for any kind of knowledge, the continuing interaction between activity, knowledge and institutional structure, and the gradual modification of informal bonds. In this dynamic setting, efficiency is not mere allocative efficiency, but rather adaptive efficiency (Pelikan, 1987), which emphasizes the capability to experiment new solutions and to adapt to new conditions. In this sense, trial and error processes performed by a large number of actors in a decentralized structure represent the most efficient model (Hayek, 1960); once more, there is a strong parallel with cultural evolution and evolutionary theory (Boyd and Richardson, 1985).

From a theoretical point of view, the use of a path-dependence model in order to explain legal (economic, social) change places emphasis on causes, rather than on results, since these latter can be explained only by referring to the mechanisms that have shaped the dynamic evolution of the system. This shift of paradigm is new both for lawyers and economists, who have devoted a large part of their analytical efforts in trying to describe a static situation, more than tracing its dynamic evolution and the factors that have determined it. In this sense, path-dependency requires an historical approach, since an accurate description and explanation can only be given in relation to existing systems, with all their peculiar characteristics. Empirical research, with a strong emphasis on timing and circumstances, becomes as important as model-building. This new perspective has both advantages and drawbacks: it is certainly better equipped to explain some complex social phenomena, but on

the other hand the characteristics of these systems and the kind of data that are required by this type of analysis make it more difficult to build theoretical models and to make predictions (Crick, 1988). Some efforts in the building of new models and instruments have already been produced in the field of biology and other branches that are referred to as 'sciences of complexity' (Stein, 1989). Nevertheless, social scientists, like lawyers and economists, should be aware that the systems that they study contain volitional agents (that is agents whose actions reflect intentions based on expectations), and therefore they have specific characteristics which are absent in biology or other natural phenomena.

Reality shows an enormous variety of systems, and history does not seem to point to a general trend to evolve towards more efficient solutions. In fact, many systems with very low returns prove to be extremely resistant, and this fact seems to contradict the evolutionary hypothesis as applied to institutions (Alchian, 1950). This enduring inefficiency can be explained by transaction costs and path-dependence: once an institutional framework has been built, it affects the possible evolutionary trends; if the kind of incentives it creates are inefficient, it is very likely that evolution will be inefficient, too (David, 1985).

5.1 Two Examples of Path-dependancy in Law: the HIV Problem and the Organization of the Legal Profession

The possible use of path-dependence for understanding legal change is exemplified by the study of legal reactions in the world to the hemophiliacs with an HIV problem (Mattei, 1997b). This problem struck all legal systems in the same way, since it has required quick and difficult decisions involving different areas, like politics, law, culture and technology. The solutions adopted by several countries (Italy, France, United States, Japan) show that under a situation of distress all legal systems react with path-dependent solutions, that is, solutions that are determined by the institutions and organizations that are already well established. This is also because, by happening simultaneously everywhere and requiring quick reaction, it could not be expected that solutions could circulate easily through transplant; in fact, a major difference in legal transplants runs between those that take place in an incremental and slow way, due mainly to the prestige of the exported model, and those that are the result of single instant decisions, as happens after a revolution (for example the export of Western legal institutions in former Socialist countries) or through forced imposition (for example in former colonial states).

The technical solution to the hemophiliacs with the HIV problem was quickly found by introducing heat treatment techniques in the early 1980s, but the institutional reactions followed different paces and paths. Two sets of elements have been crucial in shaping the outcomes. The first refers to the interplay of formal and informal institutions: the more formal institutions are

at odds with informal ones, the less efficient are the results achieved, since informal institutions will resist application of rules that contrast with them. Informal bonds exist in all societies, because they are essential for guaranteeing order in social relationships. Even if their role is clearer in simple societies, it remains crucial also in complex developed societies, which have a strong framework of formal institutions, in the form of moral codes, behavioral norms and implicit conventions. Those informal rules are diffused and dispersed in society, and they create what can be generally termed 'culture', which is the means of transmission through generations of values that shape behaviors through teaching and imitation processes. In societies without a state (Sacco and Gambaro, 1996, pp. 26-27; Sacco, 1996) these kind of ties are very important and stable, since they shape the relationships of a social group that is very homogeneous and closely connected by personal bonds (Colson, 1974). In modern developed societies a general framework of formal institutions is required to manage complexity, but in smaller and more homogeneous sectors within it informal rules can still be essential, as for example in the case of rules of conduct in political parties. The relationship between formal and informal institutions, which form a complex network, is typical of every society and every historical epoch, and it is crucial for understanding the patterns of change; it must be underlined, in any case, that the difference between formal and informal institutions is a matter of degree, moving along a continuum (North, 1990). In the short run, culture determines the choices that are made; in the long run, informal rules may change the institutional framework, and they may even lead to a change of formal rules. The easiness of this transition depends on the existing transaction costs: if the costs for propounding values and ideas are low, they will have a strong push in changing the institutions.

The other element that has influenced the institutional reaction to the HIV problem concerns the prevailing component of every legal system; broadly speaking, legal systems may be grouped according to the prevalence of one of three patterns of law: traditional law, professional law and political law (Mattei, 1997d). The prevailing pattern will determine the legal reaction in the short run, creating a process which is path-dependent, because it is determined by the pre-existing situations. Once more, the time dimension will be crucial, because the lack of time will make it harder to try and transplant a foreign solution, making it much more likely that the existing institutions will be used to perform the new task, as happened in other fields like environmental pollution, car accidents and illegal immigration. In fact, three out of four examined systems reacted in a predictable way: the US with the use of tort law through the judicial system; France and Italy with criminal sanctions and an administrative compensation system, typical of strongly centralized and bureaucratic systems. Only Japan reacted in an unpredictable way, by resorting to tort litigation, instead of the traditional solution of mediation. This outcome

is due to the strong opposition of hemophiliacs, who wanted the ruling class to take political responsibility for the HIV problem. The fact that the problem has turned from legal to political explains a revolutionary, not path-dependent reaction (Mattei, 1997b).

The importance of the institutional structure of every legal system can also help to explain the changes undergone by the legal profession in Western countries, which are not explicable on the basis of the traditional distinction between common law and civil law (Mattei, 1997c). We may view the legal profession as an organization that uses the institutional setting to achieve its ends; in this process it is shaped by existing institutions and in its turn it influences the evolution of the institutions themselves. The two existing models of organization for the legal profession are the unitary and the divided bar. As we have mentioned, the dividing line does not run along the civil law/common law distinction (Abel and Lewis, 1988): the analysis of some of the world's paradigmatic systems (USA, England, France and Germany) shows that there is a converging trend towards a unified profession since both England and France, although at a different speed, are moving in that direction, while Germany and the US have always been using this model (Mattei, 1997c). The United States are isolated from the rest of the countries in giving strong incentives to competition and litigation through the use of mechanisms like aggressive advertising and contingent fees. In European countries, on the other hand, legal professions do not push in the sense of stimulating the demand for services, but rather on limiting the supply by rigid control of access to the profession and on avoiding competition by neighboring professions. The effects of endogenous pressures, like the introduction of uniform rules by the European Community, and the push of international competition and the globalization of markets, may well force relevant changes in the future, but the reactions in the short run are bound to be path-dependent.

Endnote

Andrea Rossato authored section 1 to 4, Luisa Antonioli Deflorian section 5. Ugo Mattei supervised the work and provided most materials.

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