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Endogenous legal traditions

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ABSTRACT

A key feature of a legal system is the set of institutions used to aggregate the citizens' preferences over the harshness of punishment, i.e., the legal tradition. While under common law appellate judges' biases offset one another at the cost of volatility of the law, under civil law the legislator chooses a certain legal rule that is biased only when he favors special interests, i.e., when preferences are sufficiently heterogeneous and/or the political process is sufficiently inefficient. Hence, common law can be selected only under this last scenario. This prediction is consistent with a novel dataset on the lawmaking and adjudication institutions in place at independence and in 2000 in 155 transplants, many of which reformed the transplanted legal tradition.

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

1. Introduction

The law is deeply influenced by the legal tradition or origin, which is the bundle of institutions shaping lawmaking and dispute adjudication (Zweigert and Kötz, 1998). The two most widespread legal traditions, common law and civil law, have been transplanted generally through colonization and occupation by a group of European countries and display very diverse structures. While common law entrusts a key role to judicial precedents—i.e., case law—and allows some discretion in adjudication, civil law relies on centralized legislation—i.e., statute law—and bright-line adjudication institutions. Exploiting the exogenous assignment of these different institutions and assuming that they have not been reformed later on, the "legal origins" project has provided evidence implying that countries that received civil law display more inefficient governments and courts, less secure investor rights, and stricter regulation than those that inherited common law (La Porta et al., 2008). Nevertheless, a growing legal literature has documented a substantial evolution of legal institutions and, in particular, that countries to which common law was transplanted have been increasingly relying on statutes (Zweigert and Kötz, 1998; Roe, 2004). What are, therefore, the incentives justifying the existence of such dissimilar institutions and their counterintuitive evolution? In the present paper, I lay out a model to answer this question, and I explore its empirical implications using data on the history of the legal order of 155 countries that received their initial legal tradition exogenously, i.e., transplants (Berkowitz et al., 2003).

Building on the literature on endogenous lobbying (Felli and Merlo, 2006) and case law (Gennaioli and Shleifer, 2007a), I envision the simplest and most essential setup necessary to clarify the legal bias versus legal uncertainty trade-off faced by a society designing its legal tradition and to highlight its robustness to a plethora of different hypotheses. Formally, society is populated by three groups heterogeneous in their preferences over the harshness of punishment. I refer to this diversity as cultural heterogeneity since my test focuses on the cultural component of preferences. While under case law the legal rule is chosen by a randomly selected appellate judge bearing variable costs of overruling a precedent, under statute law it is selected once and for all by a legislator who

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bargains with coalitions of the groups and has as outside option the socially optimal rule, i.e., the mean of the groups' bliss points. Each coalition faces fixed "collective action" costs. While appellate judges' biases offset one another at the cost of legal uncertainty, the legislator chooses a certain legal rule that is biased only when he favors special interests. If cultural diversity is limited, fixed costs discourage bribes and statute law fares better than case law. When preferences are sufficiently dispersed instead, the legislator selects a law whose bias increases with the inefficiency of the political process. Under this last scenario, case law outperforms statute law when the quality of political institutions is sufficiently poor. When lower courts have the discretion to adjudicate on the basis of a legal rule slightly different from that selected by the lawmaker, statutes become uncertain and the volatility of case law falls. Thus, a "pure" common (civil) law tradition—i.e., such that case (statute) law and flexible (bright-line) adjudication institutions are employed—endogenously arises. Crucially, these results are robust to several key alternative assumptions, e.g., institutional design maximizes not only social welfare but also bribes, appellate judges are politically selected or corruptible, and the legislator is elected. While the second point clarifies that the model message is not an artifact of the asymmetry in the extent of benevolence of appellate judges and the legislator, the first one implies that the model normative predictions have a positive content and so apply also to instances in which institutional design is not democratic.

I evaluate the model predictions as follows. First, I construct a novel dataset recording the lawmaking institutions employed by 155 transplants at independence and in 2000 and four discretion-curbing adjudication institutions adopted by a sub-sample of 99 countries at the same two points in time. Contrary to the legal origins scholars' assumption, 25 countries have reformed the transplanted lawmaking institution and 95 have modified at least one of the lawmaking and adjudication institutions, which I combine through measurement models to gage the evolution of the whole bundle of institutions characterizing a legal tradition. Second, I measure cultural heterogeneity with the normalized genetic distance between the plurality ethnic group of the country that chose the lawmaking institution and that of the transplant and with the transplant ethnolinguistic fractionalization, i.e., *ELF*. In addition, I gage the quality of the political process with the normalized first principal component extracted from the POLITY IV scores *Constraints-on-Executive* and *Polity* averaged between independence and 2000, i.e., *Pc-Institutions*. OLS estimates suggest that in countries that inherited statute law reforms toward case law are more likely the widest cultural diversity is and in countries that received case (statute) law reforms toward a pure civil (common) law tradition are found where the quality of political institutions is the strongest (weakest).

This evidence is consistent with the model and, because of the primarily precolonial origins of ethnolinguistic diversity and the quality of political process, it is unlikely that it is driven by reverse causation. I cannot exclude however that the estimates are produced by the confounding impact of the colonizers' settlement strategy on *ELF*, *Pc-Institutions*, and the evolution of legal traditions. Building on this remark, I pursue a number of strategies to determine whether the correlations I uncover are, in fact, causal. First, I control for the two key drivers of the colonizers' incentives and a crucial determinant of society's preferences for a decentralized legal order like common law. Considering these observables either stepwise or all together leaves almost intact the results. Second, I show that the estimates are similar when I consider the list of origins proposed by Berkowitz et al. (2003), I focus on the transplants that did not participate in the design of transplanted institutions, I count out outliers, or I restrict my attention on the jurisdictions in which the majority of present-day inhabitants is indigenous. Given these patterns, I can exclude that my results are driven by the sample construction and/or the unobserved effects of colonization. Third, I use insights from Altonji et al. (2005) to calculate how much greater the influence of unobservable factors, relative to observables, would need to be to completely explain away the OLS estimates. I find that it would have to be on average more than five times greater than the influence of all observables. This is unreasonable given the high fit of these specifications. Finally, I build on social evolution theories to identify plausibly exogenous instruments. The two-stage least squares—2SLS hereafter—estimates are qualitatively identical to the OLS ones, and indeed I cannot reject that both *ELF* and *Pc-Institutions* are exogenous at a level nowhere lower than 10% conditional on all observables. Even though no strategy can certainly solve all the issues inherent to the measurement of institutions and cross-country data, the battery of robustness checks just illustrated makes it difficult to envision that the OLS estimates are driven by unobservables and, in particular, a mechanism different from the one I model. Therefore, I take them as consistent with causality running from cultural heterogeneity and the quality of political institutions to the evolution of legal traditions.

The model most closely related to mine is Fernandez and Ponzetto (2008) who, however, assume that the lobbies participating in lawmaking are randomly selected and that, being more prone to capture, the judiciary is less democratically representative than the legislature. Thus, albeit in the short run statute law outperforms case law, in the long run judge-made law is bound to be superior because of its evolutionary properties. This claim, which is driven by the empirically unreasonable assumption that all groups are willing to participate in policy-making (Wright, 1996), comes short of justifying the evolution of legal systems and identifying the role of cultural diversity. Yet, this is a general drawback of the extant literature. Although the comparative merits of common law and civil law have been debated for centuries, the present paper is indeed the first to document the evolution of the two bundles of institutions and to explain this dynamics through cultural heterogeneity and the quality of the political process.[1] My results cast several doubts on the putative primacy of common law and suggest that comparative law and economics should not only take into account the evolving nature of legal traditions and their endogeneity to cultural diversity and the quality of political institutions, but also the nature of the performance of interest. Guerriero (2015) shows that properly considering these points delivers conclusions consistent with the present model and very different from those drawn by La Porta et al. (2008).

The paper proceeds as follows. First, I discuss the model in Section 2. Next, I state its empirical predictions in Section 3, and I illustrate the test of such predictions in Section 4. Finally, I conclude in Section 5, and I gather proofs, tables, and figures in Appendix A.

2. Theory

I study first the choice of lawmaking institution and then the one of adjudication rules.

2.1. Endogenous lawmaking institutions

A two-layer legal system regulates a single harmful action. In the lower layer, lower courts observe only $a \in [0, 1]$ between the two

[1] Proponents of statute law (Hobbes, 1681; Bentham, 1891) stress its certainty; supporters of case law (Cardozo, 1921; Hayek, 1960) exalt the evolutionary properties of precedents. Glaeser and Shleifer (2002) also study the relationship between lawmaking and adjudication institutions. Yet, they focus on how a centralized judicial system compares with a decentralized jury system when adjudicators can be coerced by litigants.

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