

Law and Economics

Session 2

Introduction to Law and Legal Institutions
Consequences of Legal Origins

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- The traditional approach in legal scholarship and practice treats the different areas of law as autonomous bodies of knowledge.
 - Torts is to contracts as chemistry is to sociology
- Law and economics dispenses with this fiction.

Private Law versus Public Law

- Lawyers have developed a complex system of legal categories.
- One useful distinction:
- “Private law” guides disputes between private, non-government individuals.
 - Also referred to as “civil law”
 - Contract, tort, and property
- “Public law” refers to disputes where the government is a party
 - Criminal law, administrative law, and constitutional law

The main bodies of law

- Civil Law
 - Property Law – definition of property rights, e.g. zoning, patents
 - Contract Law – legal enforcement of promises
 - Tort Law – lawsuits for damages, e.g. car accidents
 - Civil Procedure – procedural rules for civil lawsuits
- Criminal Law – government punishment of social harms
- Constitutional Law – what laws are valid?
- Administrative Law – laws for the executive branch (regulation)
 - E.g. tax, environmental, antitrust

- Outline of the civil law process:
 - ① An agent (plaintiff or victim) feels harmed by another agent (defendant or injurer), and that harm gives a claim at common law.
 - ② The plaintiff hires a lawyer and files a complaint outlining the basis for liability
 - ③ Perhaps the parties settle.
 - ④ At trial, the parties present their respective cases for liability before a judge and/or jury.
 - ⑤ A verdict is rendered, and perhaps the defendant pays damages.
 - ⑥ If one of the parties feels the judgement was in error, he/she can appeal.
 - “appellant” or “petitioner” is the party filing the appeal; “appellee” or “respondent” is the other party.

Trial Process in Criminal Litigation

- Outline of the criminal law process:
 - 1 Government regulators (e.g. prosecutors) learn about a violation of a criminal law, for example from the victim or victim's family
 - 2 The police investigate and produce evidence against a suspect
 - 3 If the prosecutor believes there is enough evidence, the suspect is arrested and charged with the crime.
 - 4 Perhaps the suspect (defendant) confesses or files a plea bargain.
 - 5 At trial, the parties present their respective cases for guilt before a judge and/or jury.
 - 6 A verdict is rendered, and the judge determines a penalty (sentence) if applicable.
 - 7 If one of the parties feels the judgement was in error, he/she can appeal.
 - Prosecutors cannot appeal not-guilty verdicts, but they can appeal sentencing decisions.

How to read a court case

- Which court? What is its jurisdiction? Trial or appellate? Which judge?
- Who are the parties to the dispute? (plaintiff/defendant, petitioner/respondent)
- What are the facts? What area of law? What is the legal claim?
- Judge or jury trial?
- If appellate case, what was the decision in the lower court? Which party filed the appeal?
- Is there a controlling statute or precedent?
 - If not, how does the judge reach his/her decision?
 - If so, does the judge modify the precedent in any way?
- What is the holding? How does it redistribute wealth for the current parties? How does it affect incentives for the future?

Example Case: Butterfield v. Forrester (King's Bench, 1809)

- “This was an action on the case for obstructing a highway, by means of which obstruction the plaintiff, who was riding along the road, was thrown down with his horse, and injured, etc. At the trial before Bayley, J., at Derby, it appeared that the defendant, for the purpose of making some repairs to his house, which was close by the roadside at one end of the town, had put up a pole across part of the road, a free passage being left by another branch or street in the same direction. That the plaintiff left a public house not far distant from the place in question at 8 o'clock in the evening in August, when they were just beginning to light candles, but while there was light enough left to discern the obstruction at one hundred yards distance; and the witness who proved this, said that if the plaintiff had not been riding very hard he might have observed and avoided it; the plaintiff, however, who was riding violently, did not observe it, but rode against it, and fell with his horse and was much hurt in consequence of the accident; and there was no evidence of his being intoxicated at the time.”
- “On this evidence, Bayley, J., directed the jury, that if a person riding with reasonable and ordinary care could have seen and avoided the obstruction; and if they were satisfied that the plaintiff was riding along the street extremely hard, and without ordinary care, they should find a verdict for the defendant, which they accordingly did.”

- The legal systems of most developed countries come from one of two major legal traditions:
 - Common law tradition
 - Civil law tradition
- La Porta et al (JEL, 2008) shows that legal origins are correlated with a broad range of social, political, and economic outcomes.

- The focus of this class – the United States is a common law system (except Louisiana)
- Case-based decision-making, based on following and augmenting precedents set by previous judges
- Influenced by social norms and best business practices
- Adversarial trial process
- Originated in England and spread to English colonies.

- Code-based decision-making – judges follow the statutes written by legislators as closely as possible.
- Inquisitorial trial process
- Originated in Rome, then France, then spread to French colonies
 - also called “Continental Law”
- Law and economics hasn't had as much influence in studying the civil law tradition.

- In common law systems, the laws evolve over time through establishment and revision of precedents.
 - New legal questions arise, and social/political conditions change
 - Judges are the rulemakers
- In civil law systems, laws evolve due to new legislation
 - Legislators are the rulemakers
 - May be more susceptible to political influence by interest groups
- More on this in Session 19

Geography of Legal Origins



Figure 1. The Distribution of Legal Origin

Legal Origins, Institutions, and Outcomes

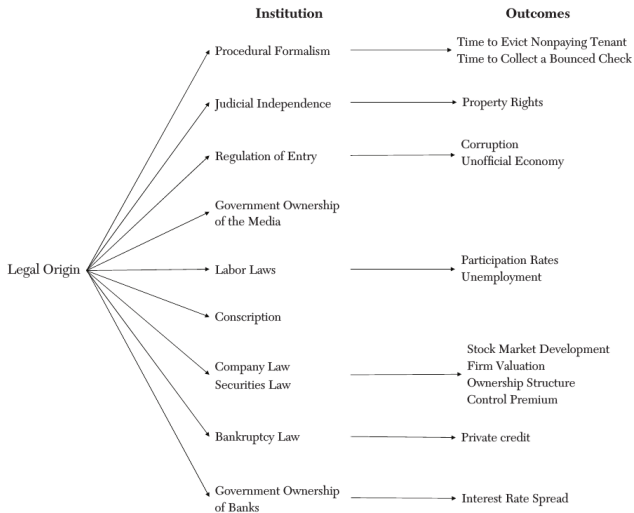


Figure 2. Legal Origin, Institutions, and Outcomes

Legal Origins and Financial Institutions

	Anti-Self-Dealing Index	Prospectus Disclosure	Creditor Rights Index (2003)	Debt Enforcement	Bank Government Ownership (1970)
French Legal Origin	-0.3334 ^a (0.0511)	-0.3298 ^a (0.0577)	-0.8394 ^a (0.2251)	-13.6361 ^b (5.6535)	0.3316 ^a (0.0755)
German Legal Origin	-0.3454 ^a (0.0736)	-0.2370 ^b (0.0966)	-0.1714 (0.2579)	-8.8577 (5.8022)	0.3456 ^a (0.1060)
Scandinavian Legal Origin	-0.3820 ^a (0.0642)	-0.2867 ^a (0.0478)	-0.9435 ^c (0.4865)	5.2707 (5.8212)	0.3109 (0.1545)
Ln (GDP per capita)	0.0728 ^a (0.0263)	0.0618 ^b (0.0261)	0.2022 ^b (0.0875)	19.8980 ^a (2.7517)	-0.1808 ^a (0.0377)
Constant	0.0177 (0.2433)	0.2102 (0.2422)	0.6043 (0.7560)	-124.6692 ^a (26.9421)	1.6206 ^a (0.2876)

Notes: ^a Significant at the 1 percent level.

^b Significant at the 5 percent level.

^c Significant at the 10 percent level.

Legal Origins and Government Regulation

	Regulation of Entry (1999)	Regulation of Labor (1997)	Press Government Ownership (1999)	Conscription (2000)
French Legal Origin	0.6927 ^a (0.0929)	0.2654 ^a (0.0362)	0.2095 ^a (0.0834)	0.5468 ^a (0.0772)
German Legal Origin	0.5224 ^a (0.1206)	0.2337 ^a (0.0473)	0.1100 (0.0926)	0.8281 ^a (0.0794)
Scandinavian Legal Origin	-0.1922 (0.1352)	0.3978 ^a (0.0443)	0.1308 ^b (0.0555)	0.7219 ^a (0.2015)
Ln (GDP per capita)	-0.1963 ^a (0.0367)	-0.0083 (0.0164)	-0.1753 ^a (0.0307)	-0.0382 (0.0331)
Constant	3.4367 ^a (0.3037)	0.3703 ^b (0.1520)	1.6565 ^a (0.3024)	0.4702 ^c (0.2802)

Notes: ^a Significant at the 1 percent level.
^b Significant at the 5 percent level.
^c Significant at the 10 percent level.

Legal Origins and Judicial Institutions

Panel A: Legal Origin and Judicial Institutions

	(1)	(2)	(3)
	Formalism Check Collection	Tenure of Judges	Case Law
French Legal Origin	1.4945 ^a (0.1841)	-0.2375 ^a (0.0620)	-0.6733 ^a (0.0951)
German Legal Origin	0.9917 ^a (0.2013)	-0.4627 ^a (0.1459)	-0.2874 (0.2156)
Scandinavian Legal Origin	0.7623 ^a (0.2966)	-0.0636 (0.0470)	0.0460 (0.0727)
Ln (GDP per capita)	-0.2610 ^a (0.0707)	0.0412 (0.0295)	-0.0004 (0.0337)
Constant	5.0505 ^a (0.6103)	0.6514 ^a (0.2500)	0.9578 ^a (0.2850)

Notes: ^a Significant at the 1 percent level.
^b Significant at the 5 percent level.
^c Significant at the 10 percent level.

Interpretation of the Evidence

- “We can think of the French civil law family as a system of social control of economic life that is relatively more concerned with disorder, and relatively less with dictatorship, in finding solutions to social and economic problems.”
- “In contrast, the common law family is relatively more concerned with dictatorship and less with disorder.”

- Acemoglu, Johnson, and Robinson, “The Colonial Origins of Comparative Development: An Empirical Investigation” (AER 2001):
 - “We exploit differences in European mortality rates to estimate the effect of institutions on economic performance. Europeans adopted very different colonization policies in different colonies, with different associated institutions. In places where Europeans faced high mortality rates, they could not settle and were more likely to set up extractive institutions. These institutions persisted to the present. Exploiting differences in European mortality rates as an instrument for current institutions, we estimate large effects of institutions on income per capita. Once the effect of institutions is controlled for, countries in Africa or those closer to the equator do not have lower incomes.”