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## **On the coexistence of different property right systems – and its consequences for economic growth and development**

### **1 Introduction**

The Hindu tradition of burning widows on the funeral pyre of their dead husbands was officially abolished in British India in 1829. Yet, instances of “suttee” – as this tradition is also called - occur until today. Also in India, although the dowry is officially prohibited, advertisements in the classified sections of many newspapers take little effort in paraphrasing that a substantial dowry is expected.

Many states the world over tried to ban the consumption of alcohol by outlawing its manufacture, transportation or sale. The US even changed its constitution, the eighteenth amendment establishing prohibition (and the twenty-first repealing it). Enormous fortunes were made due to the prohibition, Al Capone probably being the most famous figure of the time. The prohibition of trading some goods and services has often had very similar effects; just think of prostitution or drug trade.

In many “multicultural” societies, property rights systems partially overlap: is a Muslim teacher allowed to wear her head-shawl while teaching in a German school? Do Sikhs have to wear a helmet while riding a motorbike? Are Moslems – and Jews – allowed killing animals according to their tradition although this way of killing animals is generally prohibited? How are German courts to decide if fathers of Turkish or Kurdish girls have their daughters killed because their

behaviour is a disgrace to the entire family? Should they apply strict German standards or should they take the cultural context into account?

These examples seem very heterogeneous. We claim that in all of them, the coexistence of different property rights systems plays a crucial role. We are here mainly interested in the economic consequences of such property rights systems. It is the main hypothesis of this contribution that the coexistence of different property rights systems is not automatically a hindrance to economic growth and development – as often argued. But if the coexistence of different property rights systems can be both beneficial as well as a hindrance to economic development, then one needs to spell out the conditions under which one or the other will be the case. Before being able to deal with economic consequences, a number of questions need to be dealt with which will be done in the next sections, namely How to delineate different property rights systems? (section 2), What does coexistence of different property rights systems mean? (section 3), and: How does coexistence emerge? How relevant is it empirically? (section 4). We then turn to the question what the economic consequences of the coexistence of conflicting property rights systems are? (section 5). In section 5, the relevance of values and norms for property rights systems to be enforceable is emphasized. In section 6, a somewhat competing hypothesis is picked up, namely that it is the legal history of a country that determines its future prospects for economic growth and development. This hypothesis has received quite some clout in the past couple of years. Section 7 concludes.

## **2 How to define property rights systems?**

One of the founding fathers of the Property Rights Approach, Svetozar Pejovich (2001, xiii) has defined property rights as “relations among men that arise from the existence of scarce goods and pertain to their use.” A Property Rights *System* would then be a coherently ordered number of property rights that cover a potentially very high number of relations among men and regulate the use of scarce goods.

This definition implies that property rights are not confined to relationships established by means of private law (a contract concerning the exchange of a good being the paradigmatic example) but also include relationships regulated via public law: the right to vote is explicitly mentioned by Pejovich (*ibid.*). Property rights systems thus pertain to both private and public law. Many legal scholars would argue that in order to classify as property rights, individuals should have the title to make the state enforce their rights. Such a position is not equivalent with the position of legal positivism as conventionally defined. A legal positivist would argue that all rules generated by a certain procedure are legitimate law. Legal positivism is thus concerned with the generation of rules. John Austin ([1832] 1977), for example, defined positive law as the commands of a sovereign addressed to political inferiors. The legal scholar who demands of a property right that it should be enforceable by representatives of the state is not focusing on the process of producing law but on the aspect of its enforcement. Most of the time, both aspects are stressed by legal positivists but logically, this does not need to be the case.

One could call this point of view “state positivism” because it presupposes the existence of the state and some state enforcement agencies in order to talk of the existence of property rights.

It is no doubt true that the state has become extremely important in enforcing property rights. Yet, the probability that different property rights systems coexist that are all created and enforced by the state seems to be rather low. And, as the examples presented in the introduction were to demonstrate, the behaviour of many individuals is not only structured by property rights that are enforced by the state but by rules that are enforced by other individuals or organizations. We thus propose a broad delineation of property rights that is independent from the state as its role of legislator as well as that of adjudicator. There might be property rights that are neither created nor enforced by the state. Economics as a social science is interested in explaining the behaviour of individuals based on their preferences and restrictions. As long as the possibility exists that behaviour is channelled by rules that are neither created nor enforced by representatives of the state, this can have far-reaching effects on economic growth and development.

We propose to call rules that are supported by an enforcement mechanism institutions. We further propose to classify institutions with regard to the kind of enforcement mechanism used. A general dichotomy could differentiate between external institutions which are backed by the coercive monopoly of the state and internal institutions which rely on private enforcement or enforcement internal to society, thus their name. Among five types of institutions, four types of internal institutions can be distinguished according to the enforcement mechanism used (see table 1).

Table 1: Types of Institutions

Kind of Rule	Kind of Enforcement	Type of Institution
1. Convention	Self-enforcing	Type-1 internal
2. Ethical rule	Self-commitment of the actor	Type-2 internal
3. Customs	Via informal societal control	Type-3 internal
4. Private rule	Organized private enforcement	Type-4 internal
5. State law	Organized state enforcement	External

Conventions are solutions to pure coordination games, in which all participants are better off if they coordinate their behaviour. There is no conflictual element, so no participant has a preference for any particular Nash-equilibrium in case there is more than one. Once a particular equilibrium, a convention, has emerged nobody is able to make herself better off by deviating unilaterally from it. It is thus self-enforcing. Conventions are called type-1-institutions here. The rule that everybody should be driving on the right side (left side) of the road is probably the most famous example for this type of institution. Since no individual can make herself better off by unilaterally deviating from the convention, state enforcement is, at least in principle, not needed. Conventions fit into the definition of property rights cited above as they define the – conventionally accepted – use of the road which functions as the scarce good.

Moral norms are here defined as prescriptions on how to behave (or how not to behave) in specific interaction situations irrespective of the consequences on the utility of the involved individuals. Their observance can be secured either by internalisation or by private and spontaneous third-party enforcement. Moral norms, whose enforcement is secured by the actor himself, that is by internalisation, are called type-2 institutions here whereas those enforced by

others are called type-3 institutions. The latter implies an unspecified variety of persons surveying the compliance by way of spontaneous control, one possible example being to sanction non-compliance by informing others about this behaviour in order to diminish the reputation of the person who did not comply. If the threat of losing one's reputation is powerful enough to channel the behaviour of individuals, rules that are enforced like that can have wide-ranging consequences. Just think of the father of the Kurdish girl who prefers to kill his own daughter in order not to lose his reputation as the father of a respected family.

The fourth type of internal institutions are rules whose enforcement is secured by some kind of private organization. Enforcement may rely on private courts of arbitration that monitor compliance. The enforcement of rules by private organizations is called type-4-institution here. Examples for private organizations that enforce property rights are (international) chambers of commerce but also religious associations.

Rules whose non-compliance is sanctioned by the state, that is a very specific organization, are called external institutions because the sanctioning is external to society. Laws and decrees are examples for external institutions.

If the existence of property rights systems is not dependent on their being enforced by the state, the possibility for a large variety of different property rights systems that coexist opens up.

### **3 What does coexistence of different property rights systems Mean?**

In the last section, we have argued that there is a variety of ways in which rules can be enforced. If there are various enforcement mechanisms one can easily

imagine that they might be used to enforce different rules. As soon as that possibility is acknowledged, possible relationships between the various kinds of institutions just introduced move to centre-stage.<sup>1</sup> Four kinds of relationships can be distinguished: (1) they can be neutral, that is, the institutions regulate different areas of human interaction; (2) they can be complementary, that is, the institutions constrain human behaviour in an identical or similar fashion and rule-breaking behaviour is sanctioned by private individuals as well as by representatives of the state; (3) they can be substitutive, that is, the institutions constrain human behaviour in a similar fashion, but rule-breaking behaviour is sanctioned either by private individuals *or* by representatives of the state; (4) they can be conflicting, that is, the institutions constrain human behaviour in different ways. Abiding by an internal institution would then be equivalent to breaking an external one and vice versa. If the relationship between internal and external institutions is conflicting, this will increase coordination costs. If it is complementary, it will decrease them, because the state has to provide fewer resources for the enforcement of its institutions.

We propose to deal exclusively with conflicting relationships here as – at least *prima facie* – the economic consequences would appear to be the most problematic: if, say, a traditional property rights system administered by the local mullahs is respected, this is equivalent to breaking the property rights system that representatives of the state are trying to enforce on a given population. Generally, one could talk of the coexistence of different property rights systems if more than one such system is in place at one location at a single point of time. Here, this is further reduced by only talking of the coexistence of different property rights system if the respect of one such property rights system is equivalent to the

breaking of another such system that exists at the same location at the same point of time.

In principle, all four kinds of internal institutions just described can be in conflict with state-enforced external institutions. Even though a convention is a solution to a game with at least two Nash equilibria, the government's attempt to switch from one to another might arouse opposition. People could not only have gotten used to a particular convention, but also have invested sunk costs, for example a wheel on the right side of a car. Switching to a new convention would thus be costly. Ethical rules will often be based on religious concepts. If new rulers follow a different faith, actors will often remain committed to their traditional beliefs – and act accordingly. Customs can conflict with newly introduced property rights. The same holds true for the rules administered by organizations such as trade guilds.

#### **4 How does coexistence emerge? How relevant is it empirically?**

The answer to this question could be another question namely, why should there be only one property rights system? One often seems to forget that the notion of the (nation-)state whose representatives demand complete control over the rules as well as their enforcement is a rather novel concept and that over long periods of time in history, the coexistence of conflicting property rights systems seems to have been the norm. But given that we accept the notion of state, whose representatives claim to have the monopoly of legitimately threatening coercion, what are the reasons for the coexistence of conflicting property rights systems?

Property rights define the wealth of a person as well as possible income streams. It is thus very likely that their definition is subject to quarrels induced by

conflicting interests concerning their exact delineation. If one individual, or, supposedly more likely, a group of individuals, is very powerful compared to the rest of the respective society, this group has the chance to define property rights in such a way as to maximize the expected utility of its members.<sup>2</sup> Societies dominated by very powerful groups are thus not expected to experience the coexistence of conflicting property rights systems. If, however, none of the groups quarrelling on the precise definition of property rights systems clearly dominates all the other groups, the emergence of conflicting property rights systems is a possibility.

The absence of a dominant group is thus a necessary condition for the emergence of conflicting property rights systems. It is, however, not a sufficient condition. A variety of systems will only emerge if those members of society that are not member of the most powerful group are able to coordinate their interactions according to some alternative property rights scheme. Old-time traditions based on internalised values and norms are an obvious candidate here as they will often have the quality of being focal points (Schelling 1960). Religious leaders might at times be well suited to offer alternatives to the property rights system supplied by a powerful group. If an individual has a genuine choice on which property rights system to follow, the coexistence of systems promises a higher degree of individual liberty and it might even have positive effects. This topic will be taken up in the next section of this contribution.

The necessary and sufficient condition for the emergence of conflicting property rights systems have been somewhat abstract. We thus add a number of examples:

- A state has just lost a war and the foreign winner has an interest in modifying the property rights systems currently in place. Although it has just won a war, it might not be powerful enough to implement its property systems completely and many individuals in the state that lost the war might continue to structure their interactions using the property rights system that they are used to.
- A very similar situation can arise between colonizer and colony: The colonizer might be powerful enough to make a new colony but not dominant enough to implement its own property rights system.
- Another reason could be that there was a radical change of government domestically, for example a revolution, a coup or the attempt to install a democratic government. Revolutionaries might try to use the property rights system as an instrument for social change. If they are, however, not powerful enough and substantial parts of the population prefer a different property rights system; this might give rise to the coexistence of conflicting systems. This difficulty can also arise when a new government tries to implement a property rights systems adequate for the establishment of a market economy. If there are important groups who expect to lose due to its establishment, they might prefer to coordinate their interactions using different rules. Some of the transition processes of the last decade provide ample evidence for this phenomenon.<sup>3</sup>
- Yet another reason for the emergence of conflicting property rights systems is the existence of multicultural societies. If the various groups hold different values and norms, their traditional ways of structuring interactions might appear more attractive to many group members than the property rights system offered by the state.

- The last reason we want to mention here will supposedly become more important in the future: attempts to harmonize property rights systems on an international level might alienate individuals from the newly created international systems and make them stick to their national ones.

### *How to Assess Conflicting Property Rights Systems Empirically?*

After having named reasons for the possible emergence of conflicting property rights systems and after having provided some examples, we have to turn to the question how such systems can be ascertained empirically. This is, quite obviously, no mean feat. Relevant aspects include (i) the identification of the different systems, (ii) their difference concerning substance as well as procedure and (iii) their relative relevance. Note that this is no evaluation of the economic consequences yet but that these steps must precede such an evaluation. Ostrom (1996, 208) writes: "These rules may be almost invisible to outsiders, especially when they are well accepted by participants who do not even see them as noteworthy." The "difference" between the various systems can only be measured if one has a generally agreed upon metric at one's disposal which is not the case.

Ascertaining their relative relevance could be done by counting how many transactions are conducted according to which property rights system. Moreover, one could also count the number of times that various conflict-settling mechanisms are used. No empirical measure to ascertain conflicting property rights systems seems readily at hand. We now turn to discuss two possible proxies shortly.

One could first try to estimate the importance of the shadow economy or the informal sector in a given country. Almost all transactions need some sort of

structuring mechanism. Transactions executed without resort to either state-created law or state-run enforcement agencies can be thought of as being structured drawing on some alternative property rights system. The size of the informal sector can be hypothesized to be a good indicator of the relative quality of the property rights systems provided by the state: the costlier it is to structure interactions using that system, the larger the proportion of interactions that will be secured by drawing on alternative property rights systems. It is important to keep in mind that the size of the informal sector is a measure of relative quality: It does not say anything about the quality of state-offered property rights (or the alternative property rights system) *per se*, but only about their relationship. It is furthermore important not to assume implicitly a fixed number of interactions: if neither the state-run property rights system nor any of the alternative systems are capable of reducing uncertainty considerably, the total number of transactions taking place will be lower than if either of the systems performed satisfactorily.

Secondly, corruption levels could also be used as a proxy for the relevance of conflicting property rights systems. Corruption has been defined as “the misuse of entrusted power for private benefit” (Transparency International 2000, 1). For our purposes here, we propose to interpret bribes as the price for switching from a state-run property rights system to an alternative one. The amount of bribes paid could then serve as an indicator for the relevance of conflicting property rights systems.

The purpose of paying bribes is to reach results that are different from those that had attained had one not paid the bribe. Bribe paying and corruption are themselves based on informal rule systems.<sup>4</sup> The problem with this proxy is that it does not contain any information on the alternative property rights system(s)

itself. Additional problems are (i) no objective data are available<sup>5</sup> and (ii) the readiness to pay a price for not using the state-run system implies that this system does have some relevance. Assuming the various state-run systems as having the same relevance would be a heroic assumption.<sup>6</sup> In general, one could still expect corruption levels to be determined by the adequacy of property rights systems as factually implemented.

Even though we currently do not have an indicator at our disposal that would enable us to measure and compare the degree to which various societies experience conflicting property rights systems, there are a number of case studies that would seem to suggest that conflicting property rights systems have always been a problem: they have before the arrival of the nation-state and they have remained a problem even after the nation-state had been firmly rooted in many parts of the world. The examples given in the introduction can all be interpreted as cases of conflicting property rights. Many of the examples are current ones.<sup>7</sup>

## **5 What are the economic consequences of conflicting property rights systems?**

Relying on the plausible assumption that conflicting property rights are an empirically relevant phenomenon, we now want to ask whether they also are an empirically relevant problem in the sense that they inhibit growth and development. As the empirical assessment of conflicting property rights systems is difficult as such, estimates concerning their effects on economic growth will be equally difficult. In this section, some possible benefit and some cost components will be shortly discussed. As comparable data are lacking, some case studies are mentioned.

A first possible cost component of conflicting property rights systems are the costs of familiarizing oneself with more than one property rights system, thus increased transaction costs.

The co-existence of conflicting property rights systems means that if an individual behaves in accordance with one property rights system, it reneges upon another, co-existing system. In order to escape sanctions, it will often be necessary to execute transactions in a clandestine way which will lead to sub-optimal firm size, the omission of advertisement and marketing campaigns, the impossibility to finance certain projects externally and so on. This is thus a second kind of transaction costs. In general, high transaction costs will lead to a lower number of transactions taking place and the division of labour will be lower, and economic growth and development are lower than they would be with an efficient property rights system.

Suppose that the representatives of the state are keen on having a monopoly in the supply of a property rights system. If there is some alternative around, representatives of the state will have to spend more resources on implementing their system. In part, they will be made up of additional monitoring costs that are incurred to ensure that alternative property rights systems are not used. If there were no conflicting property rights systems around, resources could be put to a more productive use.

Property rights systems can be called efficient if they enable the actors to execute transactions at low cost and if non-compensated externalities between actors are absent. Suppose such efficiency was possible. Under that assumption, the existence of more than one property rights system must by necessity imply

that  $(n - 1)$  other property rights systems are inefficient. The coexistence of conflictual property rights systems would thus be equivalent to welfare losses.

The question is whether such a delineation of efficiency is empirically meaningful. The underlying notion of a social welfare function has often been criticized; the critique does not need to be repeated here. But it might still make sense to point out some problems with regard to the issue at stake. The definition of “externalities” depends on a person’s values and norms. If that is true, then different values and norms could lead to the necessity to internalise the effects of quite different behaviour. The attempt to delineate one universally efficient property rights system would thus be in vain.

#### *Some case studies*

Let us now turn to some case studies. The most important empirical study in this line of thinking is de Soto's (1990) study of three informal sectors within the Peruvian economy: informal housing, informal trade and informal transportation. De Soto's central conjecture is that the size of the informal sector is a function of the compatibility of state-run property rights and the values and norms of the concerned parts of the population, or, in his own words (1990, 12): "We can say that informal activities burgeon when the legal system imposes rules which exceed the socially accepted legal framework – does not honor the expectation, choices and preferences of those whom it does not admit within its framework – and when the state does not have sufficient coercive authority." Although the informal sector is far from anarchic, de Soto is very careful not to glorify its performance. With regard to informal business, he notes that most businesses will have to forego scale effects because beyond a certain size, it will be impossible to remain informal, that they will often remain undercapitalised because they cannot

provide the banks with the necessary securities, that they will be excluded from using certain markets such as stock markets and trade fairs, and that transactions will be accompanied by substantial information costs. Furthermore, long-term investment might well be impossible, which means that the investment rate in the informal sector will *c.p.* be lower than that of the formal sector.

Ellickson (1988, 1991) wondered whether Coase's (1960) famous example of the farmer and the rancher had any empirical content. Coase maintained that conflicts between farmers, on the one hand, and ranchers whose cattle trespass on the farmers' land, on the other, are decided by the legal system. Ellickson (1994, 97) maintains that this view "is almost certainly incorrect in any rural area in which neighbours repeatedly interact." The author studied how disputes between ranchers and farmers were settled in Shasta County, California. This county was chosen because in some parts of it ranchers are strictly liable for cattle trespassing, while in others they are not. Ellickson was able to show that, no matter what legal rules prevailed, the way neighbours resolved their conflict remained unchanged, that is, the property rights system run by the state did not have any effect on the kind of conflict-resolution chosen. This study tells us that, under certain circumstances (repeat interactions), privately administered property rights systems still trump state-run ones, even in such highly developed societies as California.

Above, a number of cost-components that can apply in cases of the coexistence of conflicting property rights systems that can be detrimental to economic growth and development were named. But would farmers in Shasta-County really be better off if they had only one (supposedly state) law to turn to? Phrased in a more general way: under which conditions is the coexistence of property rights systems conducive to additional wealth – and under what conditions does it prevent

economic growth? To rephrase the question: if there is competition between the co-existing systems, under what conditions will it lead to higher growth and under what conditions will it prevent growth? We now turn to possible benefits of the coexistence of conflicting property rights.

### *The Competition of Systems*

The competition of (property rights) systems and its welfare-effects have been debated ever since Tiebout's (1956) seminal paper who was concerned with actors moving to the municipalities that supplied public goods bundles which best suited their preferences. The paper proved to be the starting point for discussions concerning the effects of institutional competition between member states of federations as well as between nation-states. Critics have claimed that such a competition could lead to a "race to the bottom" (for example Sinn 1997); adherents believe it be an ingenious mechanism to get rid off inadequate property rights systems. This lengthy debate cannot be surveyed properly here (see, however, Kiwit and Voigt 1998 and Voigt, 1999a, chapter eight). It is closely related to the issue discussed here, yet not quite identical: The debate triggered off by Tiebout usually centres around the competition of property rights systems provided by nation-states. We are here, however, interested in the competition of property rights systems supplied by the state with those not supplied by the state or even of systems not at all supplied by the state.

Competition in general can be divided into (i) an exchange process-taking place between the supply side and (ii) a parallel process in which the actors of the same side of the market observe each other's behaviour. Competitors can imitate successful innovations, or competitors can try to top successful innovations by innovations of their own. As long as they perceive themselves as acting on the

same market, their own success also depends on the behaviour of their competitors. A first condition that needs to be fulfilled if the competition of property rights systems is to have beneficial effects therefore is that suppliers perceive themselves as competing with other suppliers. If they do not care what property rights system individuals turn to, chances that a particular system will be improved because a lower number of transactions are structured according to its rules are low. The suppliers must enjoy some utility of individuals using "their" system.<sup>8</sup>

It was pointed out above that a variety of property rights systems mean higher transaction costs. Competition between property rights systems will only be beneficial if competition leads to improvement in rules that overcompensate the additional transaction costs that have to be incurred in order to familiarize oneself with the competing systems. But that is close to a tautological formulation.

Viktor Vanberg (1992, 111) has described the preconditions that are required for institutional competition to function effectively, namely "(a) whether potentially wealth-enhancing innovations can be and are likely to be tried out; and (b) whether the mechanism of selective retention reliably operates as an error-eliminating mechanism, that is, that it reliably selects against less efficient practices (tools, routines) and for wealth-increasing practices."

These preconditions mean that wealth-enhancing institutional innovations can be identified as such. One might therefore be dealing with a problem of identification and/or evaluation. For anybody sceptical of interpersonal utility-comparisons, this can constitute a serious problem.

If the notion of institutional competition implies the hypothesis that the "better" institutions will prevail, one needs a criterion to make institutions comparable. In economics, it seems justified to take per capita income as the most general criterion. "Better" institutions would thus translate into higher per capita income. But a high per capita income will be the consequence of an entire set of institutions and not any single one. Supposedly, there is no unequivocal mapping between institutions and per capita income.<sup>9</sup>

These preconditions also mean that there must be some mechanism, which ensures that those institutions that are (comparatively) less wealth enhancing get eliminated. To check whether this is generally the case with regard to the competition of property rights systems, one should be able to specify a mechanism of systematic elimination. This will often not exist as different groups of actors often have different concepts of "efficiency". But let us have a look at a process that is often described as a success story.

The legal development of Europe is often described as a success story that owes its success precisely to the co-existence of conflicting property rights systems (see, for example, Berman 1983/1991, Jones 1987, 112). Berman identifies ten characteristics of what he calls the Western law tradition. The ninth of these characteristics is the co-existence and competition of various jurisdictions and legal systems within a single society, which, according to Berman, might be the single most important characteristic of the Western law tradition. This pluralism was, or used to be conducive to economic growth. Similarly, it was, or used to be, a source of freedom. Berman prefers the past tense here because he believes that attempts were made in the 20<sup>th</sup> century to centralize the various jurisdictions and legal systems into one centralized legislation and administration.

What were the co-existing property rights systems and how far did their jurisdiction extend? The most basic distinction is between canonical law on the one hand and non-canonical law on the other. Non-canonical law was not, however, a unified body of law – or: a homogenous property rights system – but consisted of a variety of systems that were conflicting at least in part. Berman explicitly deals with feudal law, manorial law, the law merchant, city law and King's law. He further claims that everybody in Western Christianity lived under at least two systems of law. Berman calls the entirety of legal systems „legal order“.

In general, he separates between two kinds of jurisdiction namely that over certain groups of persons and that over certain behaviour. Here is a list of the groups over which the Church claimed to have jurisdiction: (i) the ecclesiastics and the members of their households, (ii) students, (iii) crusaders, (iv) the poor, widows and orphans, (v) Jews in cases in which Christians were also involved and (vi) the travelling, including merchants and sailors. The Church claimed jurisdiction over behaviour involving the (i) sacraments, (ii) testaments, (iii) prebends, (iv) oaths and (v) sins that were supposed to be sanctioned by the Church. In the 12<sup>th</sup> century, the emerging legal science developed different areas of material law out of these groups, namely (i) family law, (ii) law of succession, (iii) property law, (iv) contract law, (v) criminal and tort law.

Berman believes that the plurality of legal systems as well as the plurality of courts increased freedom; in fact he evaluates the competing legal systems within one geographical area as an early form of the separation of powers (ibid., 471). Translated into our terminology, Berman describes the competition between the suppliers of internal institutions, namely those institutions that are administered

by an organization without being backed by the state in Max Weber's (1920/1988) sense. It is exactly this sort of competition that has been identified by various historians as the explanation for the high rates of economic growth that Europe experienced in comparison to other regions of the world (Jones 1987, Rosenberg and Birdzell 1986, see also Kennedy 1987). There are economists who claim the competition between external institutions to be advantageous. They are often quick to quote these historians as providing evidence in favour of that claim without, however, paying due share to the difference between external and internal institutions. This is problematic because nation states systematically suppress competition of the kind described by Berman. He has thus chosen his tense with care. The emergence of the nation state soon led to the suppression of this kind of institutional competition. The number of potential solutions to coordination problems that could be tested simultaneously thus dramatically decreased. One should therefore also expect growth rates to have decreased. This was, however, not the case.<sup>10</sup>

Non state-run property rights systems are often based on internal institutions such as ethical rules or customs, which are not prone to deliberate modification. If the state-run property rights system and an alternative system based on deeply ingrained values and norms are not in accordance with each other, the external property rights will not bring the desired effects about. Even worse, the property rights system could become dead letter rather soon. If a close correlation between *de iure* and *de facto* property rights systems is normatively striven for, a policy implication can be derived: If values and norms are deeply ingrained in society and are largely exempt from deliberate modification and the coexistence of property rights systems is a barrier to growth and development, state-administered

property rights systems should not be fundamentally at odds with the valid internal institutions of a society.

Now, it could be replied that many societies might have grossly inefficient property rights systems at their disposal and that this was a major reason for their relative deprivation (North 1990). Reaching a correct diagnosis is, however, not identical to have a ready-made therapy at hand. Societies might indeed be constrained by their values and norms, and improvement might only be achievable in very small steps or – in other words – path-dependence might be a hard constraint. In the (very) long run, even values and norms need not be assumed to be exogenously given anymore. Their change can also be modelled as influenced by formal institutions. But in many cases, this will only work incrementally and not in one giant step (Voigt 1999b is a very simple model along these lines).

Summing up, it has to be admitted that our knowledge concerning the growth effects of conflicting property rights systems is very limited. We have identified a number of cost components but also some possible benefits of conflicting property rights systems. Carrying out a cost-benefit-analysis seems, however, hardly possible the central impediment being the difficulties to give operational meaning to the concept of efficiency. On the other hand, it seems clear that no single property rights system can claim to be universally efficient as efficiency needs to take some constraints explicitly into account. Among them, the values and norms seem to play an important role. If they differ between groups, the property rights systems deemed to be efficient would most likely also differ.

## **6 Does a country's legal history determine its future prospects for growth and development?**

A simple hypothesis with regard to the possibility of stimulating economic growth via setting adequate property rights systems reads: The legal past of a country determines its economic present, in other words: little can be done to stimulate economic growth. Of late, this hypothesis has been pushed by a number of prominent authors. Note that this hypothesis is not identical with the one spelled out in the last section, namely that the formal property rights system of a country should be compatible with the internal institutions of a society. The hypothesis that legal history determines a country's chances to grow will be shortly presented. Some flaws in the underlying reasoning will be identified and some conclusions drawn.

Originally, La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997, 1998, henceforth "LLSV") were interested in one particular area of property rights, namely corporate finance. They grouped countries according to their legal origin. The first distinction was between common and civil law. Within the civil law tradition, they further distinguished between the French, the German and the Scandinavian law families. They found that French civil law countries have both the weakest protection of investors and the least developed capital markets, especially when compared with common law countries.<sup>11</sup> Later on (1999), legal origins are taken as proxies for the political orientations of government, for the expected degree of intervention into the market, for economic freedom and for government efficiency. After having added socialist legal systems, all countries taken into account in LLSV (1999) are grouped into one of these five traditions.

Countries are grouped into one of those five groups based on the origin of their company law or their commercial code. This is, of course, a sweeping generalization if one takes into account that many countries chose a kind of super-market approach, choosing bits and pieces from a variety of legal systems.<sup>12</sup> Nevertheless, their results are remarkable (ibid., 261):

“Compared to common law countries, French origin countries are sharply more interventionist (have higher tax rates, less secure property rights and worse regulation). They also have less efficient governments, as measured by bureaucratic delays and tax compliance, though not the corruption score. French origin countries pay relatively higher wages to bureaucrats than common law countries do, though this does not buy them greater government efficiency. French origin countries fall behind common law countries in public good provision: they have higher infant mortality, lower school attainment, higher illiteracy rates, and lower infrastructure quality.... As predicted by the political theory then, the state-building intent incorporated into the design of the French legal system translates, many decades later, into significantly more interventionist and less efficient government, less political freedom, and evidently less provision of basic public goods.”

Countries coded as “German origin” are closer to common law countries, whereas countries with Scandinavian origin turn out to be quite interventionist. The underlying hypothesis seems to be: “your legal origin is your destiny!” As this theory has received much attention lately, we propose to deal with it in a little more detail.

First of all, LLSV must assume that legal transplants are possible, no matter whether property rights systems are transplanted by conquest, colonization or voluntary adoption. If they weren't, it would be very unlikely that attempts to transplant law should have effects decades or even centuries later. Montesquieu ([1748] 1989) famously argued that legal transplants would only be possible under very exceptional circumstances. More recently, Kahn-Freund (1974) reiterated that view with some modifications, his implicit hypothesis being that private law is more easily transferable than public law. Among comparativists, there is little consent concerning the general possibility of successful transplants. Berman, for example (1983/1991, 115) maintains that Japan and China remained largely unaffected by Western law influences, Watson (1976, 83) claims the exact opposite.<sup>13 14</sup>

The possibility that property rights systems can be transplanted successfully is not only crucial for the theory advanced by LLSV, but it also plays a crucial role for our topic: if there is a positive probability that property rights systems are not successfully transplanted, this might lead to the emergence of the co-existence of conflicting property rights, most likely the traditional system and that one intended to be transplanted.

In their more general paper, LLSV basically distinguish between three law families, namely socialist, common and civil law. That socialist law tends to be correlated with an interventionist and grossly inefficient state is not counter-intuitive. What is more interesting is the difference between common and civil law families. The debate is, of course, not particularly novel. In the 60s, Hayek (1960) and Leoni (1991) argued that common law would be superior over civil law because civil law can be radically changed overnight, whereas common law

would be more stable. This would, in turn, allow private actors to form long-term expectations and to act on them, that is make long-term investments which should, *c.p.*, generate higher growth rates in common law countries.<sup>15</sup> In the 70s, it was then argued (Rubin 1977 and Priest 1977) that the common law was more efficient because parties that could deal with resources more efficiently would come to the courts until precedent was changed to the more efficient allocation of resources.

Legal scholars seem to agree that the difference between the two families is often largely exaggerated. Posner (2002, 38), for example, describes the two traditions as „convergent“ (for a similar evaluation, see, for example, Zweigert and Kötz 1996). It could furthermore be pointed out that even the most committed revolutionaries have no choice but to rely on heavy chunks of traditional law that they have set out to abolish (Böhm 1966 with regard to the French revolution). Yet, although factual differences between the two families seem to be disappearing, the regressions by LLSV are often very significant.

LLSV obtain their results based on one particular area of private law, namely the company law or the commercial code, yet their results seem to carry over to the quality of government, which is based on public law. Their implicit hypothesis must thus be that private law is clearly more important than public law, constitutional law included. Differences in government performance are explained by differences in private law. It has been argued (Grady and McGuire 1999) that rulers always have incentives to make the private law as efficient as possible the reason being that an efficient private law will increase the number of transactions and will, eventually, lead to higher tax revenue. This argument appears plausible, although it completely contradicts the LLSV approach. Both approaches must

implicitly assume that private law can be neatly separated from public law. It is this implicit assumption that we do not agree with.

Private law can be called “efficient” if it enables the actors to execute transactions at low cost and if non-compensated externalities between actors are absent. As was already spelled out above, this means that property rights systems are not confined to private law issues; there are cases in which regulation can increase efficiency. Typically, regulation is, however, not part of private law, but of public law. Furthermore, private law, in order to be implemented, must by necessity be based on public law: the police, the procuracy, the courts are all based on public law. No matter how “efficient” the private law might be, it will only induce growth and development if it is implemented, that is if it is backed by adequate public law. One could also formulate that an efficient private law is a necessary but not a sufficient condition for growth and development.

We know that *de iure* public law is often not identical with *de facto* public law. If that is the case, then even an efficient private law is not sufficient for growth and development. It is all the more remarkable that LLSV have found a significant relationship between one particular aspect of private law and government performance. But why should *de iure* private law be a perfect proxy for *de facto* private law in the first place? Here is one possible hypothesis: Focal points that help individuals coordinate their behaviour in a way different from that declared by a state-run property rights systems seem to be more readily available in private law than in public law. The co-existence of conflicting property rights systems appears thus more likely with regard to private law issues than with regard to public law ones. An alternative property rights systems pertaining to the right to vote every so many years appears far-fetched.

An alternative way to approach the question is to assume that public law is less important for common law countries than it is for civil law countries. But why should that be the case? The hint that legal development would be more decentralized and that this would in and of itself already be an important element of the separation of powers is nothing more than mere speculation, at least for the moment.<sup>16</sup> Additional questions abound: are there certain private law families that match better or worse with certain public law families?<sup>17</sup> Although very little is known about these issues, it seems to be obvious that private law families are not filled with the same countries as public law families: just think of the huge differences between many aspects of public law between England and the US, the two countries that are always grouped into the same private law family.

Feld and Voigt (2003) have inquired into the economic consequences of one aspect of public law, namely the independence of the judiciary. Focusing on the highest court of a country, no matter whether it be a constitutional or a supreme court, they find that while *de iure* judicial independence does not have an impact on economic growth, *de facto* judicial independence positively influences real GDP per capita growth in a sample of 56 countries. If the legal origin-variable as provided by LLSV is included, that is, if a variable based on private law is added, this does neither change the judicial independence indicators nor the economic control variables. In other words: inclusion of legal origin does neither improve the total explanatory power nor does it decrease the explanatory power of the judicial independence variable.

Another shortcoming of LLSV is that they do not sufficiently distinguish between legal origin and a country having been a colony. The former British and French colonies obviously play an important role in the results. Having been a

colony of the British or the French and having a British or French private law system is, however, not necessarily identical. It is, at least theoretically, conceivable that a country has adopted French law without ever having been a French colony. Persson, Tabellini, Trebbi (2001, 13) have recently found that: „French colonial origin is associated with less corruption, counteracting the positive effect on corruption of having a French legal system.“ Corruption is, of course, only one of the many aspects dealt with by LLSV. Yet, Persson *et al.* argue that it made a difference if a country only has a French legal system or if it was – in addition – a French colony. If the French exported their implementation know-how, at least one variable of interest seems to have had offsetting effects. A more fine-grained mapping (legal origin? Colonial history?) might be in order.

It might furthermore be the case that LLSV did not take the differences between the British and the French as colonial powers sufficiently into account. Zweigert and Kötz (1996) describe that the British did not try to replace Islamic, Hindu or unwritten African law. In India, the English courts were instructed to apply Islamic or Hindu law depending on the religion of the parties in cases of inheritance, marriage, caste and so on. In Africa, judges were to apply English law only to the extent that local circumstances permitted. The British did thus not insist on the material content of their law but did export the procedures, which enabled the emergence of a variety of common laws after the colonies had become independent.

The French, in contrast, strove to “improve” men in the colonies and lift them up to French standards of civilization (*ibid.*). They thus attempted to implement the material content of the *Code Civil* in all their colonies, even if there were serious conflicts between it and, say, Islamic laws. It could thus be argued that it

was not French or Civil law, *per se*, that was inapt to induce economic growth and development, but the attempt of the French to implement the material content of their law even against resistance whereas the English refrained from such attempts.<sup>18</sup> Whereas the French (tried to) export material law, the English confined themselves to the export of procedural law, which could be “filled up” according to local custom and tradition. This would, then, indicate that the French approach was much more likely to create conflicting property rights systems than the British approach. Formulated differently: successfully transplanting procedural law seems to be much easier than successfully transplanting material law. Although we have identified some flaws in the approach of LLSV, it has nevertheless enabled us to produce a hypothesis, namely that the French attempt to implement their material law has had far-reaching effect on the quality of government that remain significant to this day.

One could also argue that it is not origin that counts but the way in which law is transplanted. This hypothesis has indeed been promoted by Berkowitz, Pistor and Richard (2002). They argue that the way the law was initially transplanted and received is a more important determinant than the affiliation to a particular legal family. They claim that the origin of a legal system as identified by La Porta et al. (1998, 1999) might be a good predictor for what we call *de iure* legality, but not for the factual implementation of the law. For *de facto* legality, the way the law was transformed according to the specific situation of a society, whether it was imported voluntarily or enforced by a colonial power and so forth would be much more important. According to their findings, countries that have developed legal orders internally or adapted transplanted legal orders to local conditions and (or) had a population that was already familiar with basic legal principles of the

transplanted law have more effective legality than countries that received foreign law without any similar pre-dispositions.

Applied to the issue of the co-existence of conflicting property rights, this would mean that (i) the development of one's own property rights system or (ii) the voluntary transfer reduces the probability that conflicting property rights systems emerge.

To sum up: it has been argued that although their results are quite impressive, the story told by LLSV suffers a number of shortcomings. They did, for example, not take the different approaches of the French and the British as colonizers sufficiently into account: whereas the French really intended to export the material content of their Civil Law, the British often restricted themselves to exporting procedures, allowing the colonies to keep using their traditional property rights system to a much larger extent. More generally, it was argued that the co-existence of conflicting property rights systems appears more likely with regard to private than to public law, although the distinction is much less precise than often assumed.

## **7 Conclusion and outlook**

As pointed out in section five, there have been instances when the existence of conflicting property rights systems was conducive to economic growth. The "European miracle" is an often-quoted example. But there are also instances in which the existence of conflicting property rights systems is indicative of the inefficiency of the state-run property rights system, the story told by de Soto (1990) on Peru being an often quoted one. A number of conditions that help us

evaluate whether we are dealing with a case of the first or the second kind were developed. Yet, our knowledge concerning these conditions is clearly insufficient.

Section six was *inter alia* used to demonstrate that private und public law could often not be easily separated, as their functioning is closely intertwined. Whereas various legal families have been identified with regard to private law, nothing similar exists with regard to public law. It would not only be interesting to propose such families but also to work on theoretically possible and empirically realized relationships between public and private law families.

During the age of the nation-state that was delineated on ethnic grounds, conflicting property rights systems have only been of limited relevance as long as the group living under its jurisdiction shared similar values and norms and was autonomous in having them reflected in their (state-run) property rights system. As societies become more heterogeneous and as supranational as well as international property rights systems are striven for, conflicting property rights systems might again become very relevant soon.

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<sup>1</sup> Additionally, one should keep in mind the possibility that the extent of the groups for which a set of external institutions is valid need not necessarily be congruent with those for which a set of internal institutions is valid. Two divergences are possible: (1) a set of external institutions is valid in an area encompassing various groups that structure their interactions according to a variety of internal institutions. (2) A valid set of internal institutions is more encompassing than the validity of a set of external institutions; it could, for example, be the case that members of one groups live in two or more nation-states.

An altogether different possibility of heterogeneous internal institutions comes into play if groups are not delineated by the criterion of geographic extension. The group of diamond traders is a group interacting the world over and largely drawing on their internal institutions (see, for example, Bernstein 1992).

<sup>2</sup> It has been argued that even autocrats have incentives to erect efficient private law systems because that would enable them to receive higher tax incomes.

<sup>3</sup> Massell (1968) is a very detailed and illuminating description of how the Soviets tried to make the populations in their central Asian republics give up the Sharia – and how their efforts were almost a complete disaster.

<sup>4</sup> As anyone who has ever tried to bribe a policeman after having committed a minor traffic offense in a foreign country will readily admit.

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- 5 Although partial correlation coefficients between various measures of corruption are astonishingly high. The problem is, of course, equally relevant with regard to estimates concerning the size of the informal sector.
- 6 This would suggest the hypothesis that corruption levels should be rather low in quasi-anarchical societies.
- 7 If we had a measure of conflicting property rights systems, it would be interesting to test whether their degree is positively related to the number of ethnicities living in one jurisdiction. A measure of the so-called ethno-linguistic fractionalization is readily available and has proven to have explanatory with regard to the quality of public goods provided in Africa (Easterly and Levine 1997).
- 8 Empirically, this is often the case. Here is just one example: Until the end of the 1970s, choosing England as the forum of an arbitration clause was considered as a legal technical error although English is the *lingua franca* of international trade and many contracts were materially based on English law (Triebel/Lange 1980, 616). The reason for the declining relevance of London as a location for arbitration courts were the competences of English courts that could intervene into this private jurisdiction at any point of the procedure. The fear that London as a location could lose relevance was then the reason to reform the English arbitration laws.
- 9 Additionally, internal institutions that reflect widely held values and norms often serve as mechanisms limiting the effects of negative externalities which are a consequence of meddlesome preferences (Sen 1970). Internal institutions might ban the consumption of drugs because the knowledge of others consuming drugs could reduce the utility level of many members of a given society. If this was the reason for the emergence of particular norms, the evolution of an alternative property rights system which increases per capita income might, nevertheless, not be connected with improvements in individual utility levels.
- 10 Of course, one can argue that a reduced number of (institutional) suppliers can very well be the result of functioning competition. The concept of potential competition claims that the possibility to enter into a market would suffice to drive producer rents down. Barriers to entry can, however, be expected to be either substantial or even prohibitive.
- 11 Berglöf and Thadden (1999) have argued that the analysis offered by LLSV is “incomplete and normative conclusions are often premature.” In particular, they argue that the worldview of LLSV is one “where the main corporate governance problem is an entrenched management and weak, dispersed shareholders.” Other points of critique include: (i) the distinction between civil and common law is rather superficial; (ii) LLSV use biased or misleading measures of the quality of corporate law; (iii) the underlying causality is unclear; corporate finance might just as well drive corporate law – and not only the other way around as supposed by LLSV; (iv) the correlation between legal origin and financing arrangements might be driven by a third, unobserved, variable.
- 12 It might be interesting to rerun their regressions based on the legal origin of some other part of private law.
- 13 The seeming contradiction could be somewhat reduced if attention is paid to the time-span various authors have in mind. Zweigert and Kötz (1996, 65), for example, point out that the numerous laws imported from Continental Europe to Japan did not have an imprint on legal reality but observe that this might be slowly changing. Formulated as a hypothesis and more specifically with regard to our

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topic: the longer the period that a transplanted property rights system is backed by the state, the lower the likelihood of conflicting property rights systems remaining around.

- <sup>14</sup> A very early example for a failed attempt to transplant public law was given by the former Lord Chancellor of Henry VI, Sir John Fortescue who fled to France and then described the differences between England and the Continent in "A Learned Commentation of the Politique Laws of England" (first published in the 15th century). The superiority of the English system concerning wealth, happiness and the entire rule-system was so evident that it was hard to understand why the whole world did not simply try to emulate the British law system. His answer: The institution of trial by jury - which he evaluates positively - depended on a specific economic and social structure that was present only in England (Macfarlane 1978, 179ff.).

MacArthur's Japanese Constitution is often cited as an example for a successful transplant of public law. Yet, Inoue (1991) shows that the Japanese language version of the constitution is more compatible with Japanese internal institutions than the English language version and how the misunderstandings between American and Japanese participants to the translation of the American draft facilitated the acceptance of the new Japanese Constitution.

- <sup>15</sup> Napoleon, on the other hand, intended to create a *Code Civil* which was to remain unchanged infinitely. If government is able to credibly commit on this, the probability for change should be correspondingly low. It would be an interesting empirical topic to quantify legislative activity in various countries and to check whether it is higher in common law or in civil law countries.

- <sup>16</sup> If the countries with a common law origin display a higher degree of separation of powers as conventionally measured, common law might not be the independent variable driving the result.

- <sup>17</sup> The problem is that comparativists have mainly been interested in comparing private law systems. I am not aware of any "public law families."

- <sup>18</sup> But see, for example, Mahoney (2000) who seems to argue that the French law is "bad" whereas the common law is "good".