The Economics of Lawmaking

FRANCESCO PARISI ⁄⁄ VINCY FON

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To my parents, Raffaele Parisi and Clara Sdino Starace,
who showed me the beauty of analytical rigor and the power
of simple thinking. ※ F.P.

To my late father, Mincio Fon, who inspired and encouraged
me to become an academic, and my mother, K. C. Au, who enticed
me to work hard by drawing my attention to my
brother's accomplishments. ※ V.F.

Acknowledgments

SCHOLARS WITHIN THE SO-CALLED LAW and economics tradition have traditionally taken a normative or positive approach to the study of law. Both approaches focus on the role of law as an instrument of behavioral control and treat lawmaking processes and institutions as exogenous. A more recent trend in the literature, developed at the intersection of law, economics, and public choice theory, has extended the economic analysis to the institutional design of lawmaking. This literature revisits the traditional conceptions of lawmaking, treating lawmaking process and institutions as endogenous. Alternative sources of law are evaluated considering their respective advantages in the production of legal order. With this book we wish to contribute to this literature, providing a comprehensive study of alternative lawmaking processes, which emphasizes the respective advantages and proper scope of application of legislation, judge-made law, customary law, and international law in the creation of a legal order.

This book is the result of several years of collaborative efforts of its authors. We wish to thank our mutual friend and former teacher David Levy for giving us the idea of collaboration during a holiday party in 1999. At different points in time, David Levy was our economics professor and knew our complementary skills (and weaknesses). His suggestion led to the fruitful collaboration and friendship of the present authors. The decision to write a book on the economics of lawmaking was far from the plans at the beginning of our collaboration. Our prior research and teaching interests were quite different from one another. One of us was teaching in a law school in the field of comparative and international law, while the other was teaching mathematical economics and economic theory courses in an economics department. Our backgrounds brought different insights and layers of understanding to the problems that we chose to study in the course of our collaboration. One topic after another, we began to realize that the problems that we chose to analyze followed a clear logical structure—a structure that

we ultimately chose to carry forward in a more systematic fashion for the writing of this book.

Several of the chapters in this book were published before in some form and, unless otherwise noted, were jointly authored by the present authors. The adaptations of the original articles for the present book were made by Francesco Parisi to improve the unity of the analysis and cohesion of the presentation, while preserving the structure and mathematical formulations of the original papers. We thank the copyright holders for their permission to reprint our articles in this book. The first three sections of Chapter 2 are based on our article "On the Optimal Specificity of Legal Rules," originally published in the *Journal of Institutional Economics* (2007), © 2007 by Cambridge University Press; the fourth section of Chapter 2 is based on an article by Francesco Parisi originally published under the title "Harmonization of European Private Law: An Economic Analysis" in M. Bussani and F. Werro (eds.), *European Private Law: A Handbook* (Staempfli Publications Ltd., 2008), © 2008 by Staempfli Publications Ltd. Chapter 3 is based on material originally published as "The Value of Waiting in Lawmaking" in the *European Journal of Law and Economics* (2004), © 2004 by Springer Publishing Company. Nita Ghei was a coauthor of that article, and we are grateful to her for allowing us to include it in this book. Chapter 4 was written by Francesco Parisi in collaboration with Emanuela Carbonara and Barbara Luppi and is based on a working paper originally circulated under the title "Self-Defeating Subsidiarity" in Minnesota Legal Studies Research Paper 08-15. We are grateful to Emanuela Carbonara and Barbara Luppi for allowing us to include this chapter in the book. Chapter 6 is based on our article "Litigation and the Evolution of Legal Remedies" published in *Public Choice* (2003), © 2003 by Springer Publishing Company. Chapter 7 was originally published as "Litigation, Judicial Path Dependence, and Legal Change" in the *European Journal of Law and Economics* (2005), © 2005 by Springer Publishing Company. Ben Depoorter was a coauthor of that article, and we are grateful to him for allowing us to include it in this book. Chapter 8 is based on our article "Judicial Precedents in Civil Law Systems: A Dynamic Analysis," published in the *International Review of Law and Economics* (2006), © 2006 by Elsevier. Chapter 10 is based on an article published as "Role Reversibility, Stochastic Ignorance, and Social Cooperation" in the *Journal of Socio-Economics* (2008), © 2008 by Elsevier. Chapter 11 is based on our article "International Customary Law and Articulation Theories: An Economic Analysis," published in the *International Law and Management Review* (2007), © 2008 by BYU International Law and Management. Chapter 12 is based

on our article "Stability and Change in International Customary Law," to be published in the *Supreme Court Economic Review* (forthcoming, 2009), © 2009 by University of Chicago Press. An earlier draft of that article was awarded the 2004 Garvin Prize in Law & Economics for Best Workshop Paper by the University of California at Berkeley. Chapter 14 was previously published as "Formation of International Treaties" in *Review of Law and Economics* (2007), © 2007 by BEPress. Chapter 15 is based on our article "The Economics of Treaty Ratification," originally published in the *Journal of Law, Economics and Policy* (2008), © 2008 by Journal of Law, Economics and Policy. Chapter 16 is based on a working paper originally circulated under the title "The Hidden Bias of the Vienna Convention on the International Law of Treaties," to be published in the *Review of Law and Economics* (forthcoming, 2009), © 2009 by BEPress. The remaining chapters—1, 5, 9, and 13—as well as the introductory and concluding chapters were written for the present book by Francesco Parisi, who wishes to express his personal gratitude to Professors Robert Cooter and Pietro Trimarchi for their friendship and guidance in academia.

This book could not have been completed without the support of our families and friends during these years of research. We are especially grateful to our spouses for their inspiration, their unwavering support, and their willingness to accept our long absences while we worked together. More colleagues than we could have hoped to enlist have provided comments and suggestions on prepublication drafts of the articles included in this book. We particularly want to thank Alessandra Arcuri, Daniel Benoliel, Omri Ben-Shahar, Lisa Bernstein, Margaret Brinig, Frank Buckley, Guido Calabresi, Emanuela Carbonara, Loyd Cohen, Robert Cooter, Tyler Cowen, Anthony D'Amato, Giuseppe Dari-Mattiacci, Gerrit DeGeest, Ben Depoorter, Gianluca Fiorentini, Luigi Franzoni, Nuno Garoupa, Claire Hill, Bruce Kobayashi, Eugene Kontorovich, Ejan Mackaay, Richard McAdams, Brett McDonnell, Jacob Nussim, Jide Nzelibe, Daniel Polsby, Eric Posner, Richard Posner, Felix Reinshagen, Charles Rowley, Alan Sykes, Paul Rubin, Thomas Ulen, Georg Von Wangenheim, Richard Wagner, David Weissbrodt, and Todd Zywicki for their valuable comments and constructive criticisms. We are also extremely grateful to Dan Milkove and Julie Hunt for their help and careful suggestions throughout the production of this book, to Catherine Sevcenko for her willingness to share her extensive knowledge of the literature, and to Ben Week, Joshua Rusenko, Ian Beed, and Matt Hurm for their research and editorial assistance.

As is customary in our profession, previous incarnations of this book went through an extensive refereeing process. The current version reflects

changes (in both substance and organization) that were suggested by the anonymous reviewers. The current version of the book has greatly benefited from their input. Finally, we are grateful to the participants in the 2004, 2005, and 2006 American Law and Economics Association Annual Meetings; the 14th John M. Olin Conference in Law and Economics at the University of Toronto, Canada; the Workshop in Economic Dynamics at the Max Planck Institute in Jena, Germany; the CASLE Workshop in Law and Economics at the University of Ghent, Belgium; the Levy Workshop in Law and Economics at George Mason University; the 2005 European Association of Law and Economics Annual Meeting; the Economic Analysis Workshop at the U.S. Department of Justice; and the participants in the Faculty Workshops at the New York University Economics Department, the University of California at Berkeley School of Law, the University of Amsterdam Economics Department, the University of Hamburg Graduate College, the University of Aix-Marseille, the Northwestern University School of Law, the University of Minnesota Law School, and the University of Chicago Law School Workshop in International Law and Economics for their valuable comments, criticisms, and suggestions on individual portions of this book presented at those events.

Introduction

ALL LEGAL SCHOLARS, at some time in their legal careers, ponder the fundamental questions concerning the sources of law. How should laws be made? Who should make them? Despite their theoretical and practical importance, sources of law have not enjoyed a systematic treatment in the existing law and economics literature. This book attempts to remedy this shortcoming, providing some novel insights for the institutional theory of lawmaking. We consider four different methods of lawmaking, which we describe respectively as (1) lawmaking through legislation; (2) lawmaking through adjudication; (3) lawmaking through practice; and (4) lawmaking through agreement.

The sources of law considered in this book have different degrees of importance depending on the legal system in question. It is well known, for example, that there is a substantial historical difference between the role played by legislation and judicial precedents in the civil law and common law and traditions. In early legal systems, written legislation was utilized with great parsimony and great weight was given to customary sources of law. Occasionally, sources of customary law were unable to provide solutions to emerging legal issues and to satisfy the changing needs of society. In these cases, precedents were recognized and followed as a matter of outright necessity. With the gradual expansion of statutory law, the recognition of precedents as sources of law was no longer a practical necessity. In this historical context, legal systems have developed a variety of doctrines to determine the effective role of customary rules and judicial decisions in the presence of legislation. In past decades we have also witnessed a great expansion in the role of international treaties in affecting substantive areas of domestic law. The resulting transformations in the legal landscape and the persistent variations in the role played by these sources of law in contemporary legal systems have, in many ways, inspired us to examine this increasingly important type of lawmaking.

The aim of this book is to provide insight on the relative advantages and the respective limits of alternative sources of law. We consider some characterizing features of our sources of law and examine them with the aid of the formal methods of economic analysis and public choice theory. We have proceeded in the analysis despite the absence of established conventions in the literature regarding the identification of relevant topics. The selection of issues and organization of the book was far from easy and greatly benefited from the early feedback of various anonymous readers and referees. The final selection of topics strikes a balance between the need for systematic exposition of the chosen topics and attentiveness to their practical relevance. We are hopeful that our chosen approach and findings will shed some light on the important issues that concern the institutional design of lawmaking.

The book is divided into four parts, each focusing on one of the above four methods of lawmaking. For each part we provide a brief introduction to the main issues and a brief review of the relevant literature. In Part 1 we consider sources of law that depend on political collective decision making, such as legislation, codifications, and regulations. We organize the analysis in three substantive chapters considering (1) optimal specificity of legal rules (Chapter 2); (2) optimal timing of legal intervention when lawmaking is carried out under uncertainty (Chapter 3); and (3) optimal territorial scope of law, addressing issues of subsidiarity and legal harmonization (Chapter 4). In Part 2 we consider sources of law derived from adjudication, such as legal precedents and judge-made law. We again organize the analysis in three substantive chapters considering (1) biases in the evolution of legal remedies through litigation (Chapter 6); (2) the role of litigation and judicial path-dependence on judge-made law (Chapter 7); and (3) the effect of alternative doctrines of legal precedent, such as *stare decisis* and *jurisprudence constante*, on the dynamics of legal change (Chapter 8). In Part 3 we consider sources of law derived from practice, such as customary law and other spontaneous sources of law. The three substantive chapters consider (1) which conditions are best capable of fostering the emergence of customary law (Chapter 10); (2) the role of articulation theories in the formation of customary law (Chapter 11); and (3) the dynamics of change of customary law (Chapter 12). In Part 4 we consider sources of law derived from explicit agreements, such as international treaties and conventions. The three substantive chapters cover (1) the process of formation and accession to international treaties (Chapter 14); (2) the ratification and reservations to international treaties (Chapter 15); and (3) the effect of the 1969 Vienna Convention governing

the law of treaties, and the possible bias created by this treaty when heterogeneous states are involved (Chapter 16).

Throughout the book, our findings are examined with the discussion of some of their normative corollaries. We revisit the traditional presentation of sources of law by considering the important issue of the institutional design of lawmaking through the lens of economic analysis and public choice theory. Our analysis addresses several key issues from public choice theory. They are (1) issues of minimization of lawmaking costs, (2) agency problems in representation, and (3) issues of stability of collective decision-making outcomes. These concerns influencing the institutional design of lawmaking should be kept in mind as the reader progresses through the book, and they will prove helpful in identifying commonalities and differences in the various sources of law considered. Our functionalist approach to legal analysis will hopefully shed new light on the process of law formation, emphasizing the respective advantages and proper scope of application of legislation, judge-made law, customary law, and international law in the creation of a legal order.

Contents

PART I

Lawmaking through Legislation

Codified Law

ONE

Lawmaking through Legislation

An Introduction

THE DIFFERENCES IN LEGAL SYSTEMS often reflect different ideologies and conceptions of the political economy of lawmaking. In recent decades, modern countries have been giving increasing importance to written statutes among their sources of law. The supremacy of written law over other sources of legal order is not, however, universal. The conventional distinction between common law and civil law systems is based on conceiving legal traditions as a dichotomy. Systems of the civil law tradition, the conventional thinking goes, tend to give greater weight to written and statutory sources of law. Generally speaking, these systems derive historically from a legal tradition that recognized the authority of a comprehensive body of written law (e.g., the Roman Corpus Juris). The common law tradition, by contrast, evolved from the tradition of casuistic reasoning pioneered by Aristotle; this tradition consisted of comparing the case to be decided against a paradigmatic case (i.e., a precedent). Unlike a legal code written ex ante that can remain more or less static over time, the law would evolve as judges subsequently relied on some decided cases but not others for their precedential value.

In most legal traditions, legal pragmatism has informed much of the debate and traditional dogmatic principles are no longer seen as providing bright-line guidelines in the balance between legislative and judicial sources of law. During the last several decades this pragmatism has allowed substantial methodological convergence between legal systems of the world. In the common law tradition, the proliferation of legislative intervention has gradually corroded the traditional dominance of judge-made law; in the civil law tradition, increasing weight is given to judicial decision making, and statutes and case law coexist, more or less happily, with one another.

In the following three chapters, we will examine three related dimensions of legislative lawmaking. Lawmakers can choose among different variables: the level of specificity of a law, the timing of legal intervention and revision of the law, and the territorial scope of application of the law. These interrelated

choices represent critical ingredients in any legislator's attempt to maximize the net present value of legislation.

1. Optimal Specificity of Legislation

With respect to the issue of optimal level of specificity, we should consider that lawmakers can craft laws with different levels of detail to guide judges in their decision-making process, incorporating detailed rules or more general standards into the laws they write. In the existing literature, the problem of optimal degree of specificity of laws was first discussed by Ehrlich and Posner (1974) and Schwartz and Scott (1995), who structured their seminal papers around the rules versus standards dichotomy. Ehrlich and Posner (1974) offer a formal optimization model that is static. Schwartz and Scott (1995) model rule making in the context of private legislatures as a single-shot, multistage game. They outline a theory of the legal process which holds that the degree of precision in the formulation of laws is largely based on the desire to minimize social costs. With the knowledge that specific legal rules and general legal standards lie at opposite ends of the spectrum, Ehrlich and Posner articulate the criteria for determining the optimal degree of specificity, given cost minimization as a dominant consideration. They discuss the benefits that precision brings to the legal system, including increased predictability and the consequential reduction in litigation expenditures, increased speed of dispute resolution, and reduced information costs associated with adjudication. Yet precision also involves costs: the costs of rule formulation, which are often substantial, given the high transaction costs of statutory decisions; allocative inefficiency arising from both the over- and under-inclusive effects of rules; and information barriers for the layman, who is more likely to understand general standards than specific rules, which employ technical language.

In Chapter 2 we address this issue with the aid of the analytical tools of modern investment theory (a theory analogizing a law to an investment), studying the optimal degree of specificity and the functionality of rules or standards under different environmental conditions. In the presence of uncertainty, we can view legal systems as making investment decisions that create present lawmaking costs and which generate uncertain future benefits. Lawmaking costs are at least partially sunk (i.e., lawmaking costs cannot be recovered if the enacted rule proves to be ineffective or undesirable at a later time) and exogenous changes in the regulated environment