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**ARE INTERNATIONAL MERCHANTS STUPID? - A NATURAL EXPERIMENT
REFUTES THE LEGAL ORIGIN THEORY***Working Paper No. 21 / 2005*

Are International Merchants Stupid? - A Natural Experiment Refutes the Legal Origin Theory

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Abstract.

In economics, there is currently an important discussion on the role of "legal origins" or "legal families". Some economists claim that legal origins play a crucial role until today. Usually, they distinguish between Common Law, French, Scandinavian and German legal origin. When these legal origins are compared, countries belonging to the Common Law tradition regularly come out best (with regard to many different dimensions) and countries belonging to the French legal origin worst.

International arbitration provides an ideal "natural experiment" to test this view empirically: in international trade, the contracting parties are free to choose the substantive law that suits their interests best. If the literature just cited was correct, we would expect that rational traders would structure their interactions according to some substantive law based on the Common Law tradition such as British or US American law. Although exact statistics are not readily available, the evidence from cases that end up with international arbitration courts (such as the International Court of Arbitration run by the International Chamber of Commerce in Paris) clearly demonstrates that this is not the case.

JEL classification: F23, K12, P48.

Key Words: Legal Origins, International Arbitration, Choice of Substantive Law.

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Are International Merchants Stupid? - A Natural Experiment Refutes the Legal Origin Theory

I. Introduction

The conjecture that the legal origins of a country determine the quality of its government until today has spread like an epidemic in economics. Although the debate concerning the relative merits of common vs. civil law has been going on for decades and legal comparativists have traditionally distinguished between a number of legal systems or legal families, the literature got a real boost with a number of papers authored by La Porta, Lopez-de-Silanes, Shleifer, and Vishny (LLSV for short) in the late 90ies (1997, 1998, 1999).¹ Indeed, LLSV has become somewhat of a brand name by now. The number of citations is indeed stunning: on April 22, 2005, the academic search engine “scholar.google.com” contained 1105 electronically available papers that had cited the 1997 paper. The 1998 paper was cited 1483 times, and the 1999 paper still a very noteworthy 447 times. The numbers are truly stunning. For comparison, Coase’s (1960) paper on social cost, often considered the most cited economic paper of all times, got 1916 quotes.

Distinguishing between common law, socialist law and three different civil law families (French, German, Scandinavian), the authors find (1999, 261) that

“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.”

Hence, the results are at least as stunning as the number of citations. The classification into one of the legal origins is done based on the private law of a country, i.e. on the law

¹ We will stick to this convention although the 1998 should really only be called “LLS”.

that orders the horizontal relationships between actors – and not their relationship to the state. But most of the effects dealt with in the citation have to do with aspects of public law, as, e.g., tax rates or regulation. Implicitly, LLSV thus argue that private law dominates public law.

This paper uses a very simple natural experiment to test some aspects of this claim empirically. In international trade, the contracting parties are free to choose the substantive law that suits their interests best. We assume that rational traders are interested in the best possible *ex ante* protection of their property rights. If French law does not adequately protect private property rights, we would not expect international traders to choose it as their substantive law. Correspondingly, if Common law offers them a better basis to conduct business, we would expect them to choose one substantive law out of this legal family to structure their interactions. The international associations that offer arbitration services are reluctant to publish many data concerning these questions. Yet, the little available empirical evidence is sufficient to refute the hypothesis that follows from the legal origin discussion. French, but also Swiss law, are chosen more frequently than could be expected. American law is chosen less frequently than expected. With regard to international arbitration, there is thus reason to argue that legal origins are largely irrelevant. On the basis of the little available data, an even stronger claim can be made: if merchants choose the substantive law that suits their interests best and U.S. American law is chosen less frequently than French or Swiss law, this indicates that U.S. law is less efficient than its competitors.

The paper is organized as follows: section two describes the legal origin hypothesis in a little more detail, spells out some of the underlying assumptions as well as the implications and criticizes some aspects of the argument. Section three presents some of the relevant institutions and organizations used by international merchants to structure their interactions and contains the description of the natural experiment analyzing the choice of substantive law by international merchants. Section four contains a discussion of the results. Section five concludes.

II. The Legal-Origin Hypothesis: Assumptions, Effects, Implications, Critique

The two most important findings of the legal origin discussion as presented by LLSV seem to be that (1) the legal past of a country determines the present quality of its government and that (2) the characteristics of its private law are a better proxy for the present government quality than proxies much closer to public law such as form of government, electoral systems, degree of separation of powers, independence of the judiciary etc. This section serves to present their argument in greater detail, to spell out some of the assumptions and implications, but also to criticize their argument.

In their paper on the quality of government, LLSV (1999) 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 in line with our intuitions. What is more interesting is the difference between common and civil law families. It is often argued that in civil law countries, it is parliamentarians that can “make” law, whereas in common law countries, it is the judges who “find” it. An important role is ascribed to precedence or *stare decisis* in common law countries. The debate is, of course, not particularly novel. In the 60s, Hayek (1960) and Leoni (1961/1991) argued that common law would be superior to civil law because the latter can be radically changed overnight, whereas the former 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.² In the 70s, it was argued (Rubin 1977, Priest 1977) that common law was more efficient because parties that could deal with resources more efficiently would resort 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). Although factual differences between the two families seem to be disappearing, LLSV’s

² 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.

results are often very significant. Yet, LLSV dig a bit deeper with regard to civil law origins because they distinguish between French, German and Scandinavian families. We have already cited the results concerning French law. With regard to German legal origin, LLSV (1999, 262) find that “these countries are rather similar to those of common law origin”. With regard to Scandinavian legal origin, they find that they are sharply more interventionist though not less efficient. These results are interesting – and potentially undermining LLSV’s more general argument: If the general distinction is between common and civil law and the more fine-grained one within the civil law family, then one would expect all members of the civil law family to do worse – or better – than the other families. That two out of three members of the civil law family do just as well as common law might be an argument in favor of the more fine-grained distinction but lets the more general distinction between common and civil law appear questionable.

Let us now turn to some of the implications of the LLSV view of legal origins: First of all, they must assume that legal transplants are possible, no matter whether transplantation is by conquest, colonization or voluntary adoption. Former British colonies are almost always coded “English” legal origin³, former French, Spanish, Portuguese, and Belgian colonies always “French” (except where they are Socialist as Vietnam, e.g.). This coding appears plausible, but questions arise nevertheless: If the effects of legal systems are “very long term”, should the countries not be coded according to their pre-colonial system? And if the very long term effects are so important, why not code some of the formerly socialist countries in Central and Eastern Europe as German instead of socialist?

Another problem 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. However, having been a British or French colony and having a British or French private law system is not necessarily the same thing. It is, at least theoretically, conceivable that a country has adopted French law without ever having been a French colony. As Persson, Tabellini, and Trebbi (2004) have recently found: „French colonial origin is associated with less corruption,

³ Egypt and Mauritius that used to be British colonies but are coded as belonging to French legal origin seem to be the only two exceptions.

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. Joireman (2004) recently found that a sample including all common law countries does not score significantly better than countries of other legal origins with regard to the rule of law. This was only the case if the sample was reduced to former colonies. This is, thus, another study confirming the relevance of having been a colony. A more fine-grained mapping (legal origin? Colonial history?) might thus be in order.

Furthermore, it might be the case that LLSV did not sufficiently take into account the differences between the British and the French as colonial powers. Zweigert and Kötz (1996) assert 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 thus did 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.⁴ 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. In other words: successfully transplanting procedural

⁴ But see, for example, Mahoney (2001) who seems to argue that the French law is “bad” whereas the common law is “good”.

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 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 LLSV (1998, 1999) might be a good predictor for what I would call *de jure* 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.

Glaeser and Shleifer (2002) have endogenized the choice of legal systems. Comparing England with France, they argue that the different structural characteristics of both systems could have been adapted to the different environment, both choices might thus have been efficient. One environmental condition gets special attention, namely the amount of bullying observed in a country. They (2002) write: “In contrast, the transplantation of rules designed for a system with little bullying into a system with a greater amount can lead to the breakdown of the rule of law.” The French system is better suited for countries with a high amount of “bullying” than the English system. Given that “bullying” was higher in the former colonies, would this not imply that the transplantation of French law is better able to protect the rule of law than English law? But is this implication not entirely at odds with LLSV?

There is an extensive law and economics literature on the characteristics of efficient private law. Most generally, private law is efficient if it enables the actors to execute wealth-creating transactions at low cost and if non-compensated externalities between

actors are absent. Additionally, liability should be with the least-cost avoider etc. But no matter how efficient the private law is, it will only be enhancing economic development if it is backed up by an adequate public law. Private law is thus a necessary but not a sufficient condition for economic development. The promise of a government to respect and enforce private property rights will only be credible if adequate public law organizations are available. The police, the procuracy, the courts are all based on public law.

LLSV obtain their results based on one particular area of private law, namely corporate law, 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.

Acemoglu and Johnson (2003) plead for an “unbundling” of institutions in order to determine their effects on economic outcomes one by one. They distinguish between property rights institutions (PRI) and contracting institutions (CI). Whereas the former protect property owners from government infringement into their rights, the latter order the interactions between private actors. This distinction neatly corresponds with ours: PRI is part of public law, whereas CI is part of private law. Their basic hypothesis is that inadequate PRI are a lot worse for the development prospects of an economy than inadequate CI: if the private law of a country is not in accordance with the needs of traders and merchants, they can always – albeit at a price – circumvent using the CI supplied by the state. If the public law of a country is, however, not conducive to the protection of property rights, there is no way to circumvent its application (except for leaving the respective jurisdiction which will, however, reduce its growth prospects even further). The hypothesis thus runs directly against the LLSV hypothesis; whereas they argue that private law is more important than public law, Acemoglu and Johnson argue the exact opposite. Acemoglu and Johnson test their claim empirically, using “procedural formalism” as a proxy for the quality of CI. Drawing on seven different criteria such as written as opposed to oral litigation, the number of steps in court proceedings etc., Djankov et al. (2003) show that procedural formalism is highly correlated with legal origins. Acemoglu and Johnson use this indicator and find that “... once we control for the effects of property rights institutions, legal formalism seems to

have no impact on income per capita, the investment to GDP ratio, and the private credit GDP ratio.”

To sum up: although their results are quite impressive, the story told by LLSV suffers a number of shortcomings. The coding of some countries appears questionable, possible interdependencies between legal origins and former colonies are not explicitly dealt with and the implicit assumption that private law is more important than public law for a country’s development seems to be refuted by the evidence provided by others.

III. A Natural Experiment

We now turn to a natural experiment that can serve as another empirical test concerning the validity of the LLSV view of the world. If civil law, and in particular French law, is clearly inferior to common law, then rational actors who have the possibility to opt out of French law – and into a more efficient legal system – should be expected to do so. Whether they actually do so will be analyzed in this section. Before getting to the numbers, some of the institutional prerequisites of international trade will be very shortly described.

There are a number of reasons why non-state court arbitration is so frequently preferred over state court arbitration in international contracts:

- (1) When private law subjects from different jurisdictions negotiate the details of a contract, they are often afraid of the so-called “*home bias*” of state courts, i.e. the tendency of state courts to decide in favor of the party originating from their jurisdiction.
- (2) Many states are reluctant to enforce the decisions of courts of other states as this is perceived as an undue acceptance of other legal systems and would involve an – unwanted – abdication of one’s own sovereignty. But all states that have ratified the New York Convention have pledged to enforce decisions made by non-state courts. Ex ante, *enforcement* is thus more likely if non-state court arbitration is chosen.
- (3) Passed a certain threshold concerning the monetary claims involved, non-state arbitration is cheaper with regard to out-of-pocket *costs*.

- (4) The sequence of courts is often reduced to one in non-state arbitration, which means that the judicial decisions are reached a lot faster than in state courts. This increases *certainty*, which is highly valued by businesspeople.
- (5) In private arbitration, the judges do not necessarily have a legal background but can be engineers, physicists etc. Many businesspeople believe that it is an advantage to have “*issue experts*” judging their case.

All these reasons explain why such a large majority of international contracts (between 80 and 95%) do not rely on state courts at all, but on non-state arbitration that is often administered by specialized organizations such as international chambers of commerce. Opting out of state court administered jurisdiction does, however, not imply to opt out of substantive state law. Although it is theoretically possible to do so and to refer, e.g., to the *lex mercatoria*, more than 80% of those international contracts that contain a choice-of-law clause are concluded on the basis of the substantive law of a state (International Court of Arbitration 2004).⁵ By now, it is well-known that all contracts are by necessity incomplete, i.e. it is impossible to anticipate all possible contingencies completely and to specify the legal consequences accordingly. In case a situation arises that has not been dealt with in the contract, the chosen substantive law becomes relevant: it serves as a subsidiary law that is to “fill the gap” left in the contract. Derains (1995, 10) claims that it is “not possible to overemphasize the importance of the law applicable to the contract.” The question then is: what factors determine its choice?

From an economic point of view, one would expect each of the contracting parties to propose that law to its contracting partner that promises the highest expected benefits to itself. Aspects that possibly play in here include

- (1) the *familiarity* with a private law system. A high degree of familiarity involves a low degree of additional transaction costs that have to be incurred.
- (2) the *predictability* of decisions made by arbitrators based on the respective law. The predictability, in turn, depends on the precision of the relevant laws; predictability is, of course, closely related with certainty whose relevance has

⁵ More precisely, 82% of the contracts underlying the disputes referred to ICC arbitration in 2003 contained a choice-of-law clause specifying the applicable law. In 80.4% of these cases, the parties opted for a national law.

already been mentioned above. Predictability further depends on the stability of the relevant law.

- (3) the *perceived fairness* of the relevant laws. *Ex ante*, parties do not know whether they will ever be plaintiffs or defendants, which means that they have incentives to consent on a law that does not unduly favor one of the parties.

Due to (1), we expect that most contracting parties propose the law of their own country as the law applicable to the contract. If there is a power asymmetry between the parties, we can thus expect that the substantive law of the more powerful country will be chosen as the applicable law. If there is no power asymmetry, it seems reasonable to expect that the contracting parties will agree on some law of a third state that satisfies considerations (2) and (3).

Comparing legal systems with regard to (2), it could be that common law systems have a systematic disadvantage here because the law is “discovered” by judges, implying that it is not sufficient to know legislation in order to know the currently valid law, but also many court decisions. This can cause two different types of costs, namely (i) higher transaction costs in ascertaining the currently valid law and/or (ii) higher transaction costs in trying to spell out as many contingencies as possible in the contract which makes contracts more complex, lengthier etc.

If a substantive law is subject to the danger of heavy government intrusion into private property rights, then this substantive law will not be chosen by international business representatives, simply because it would reduce predictability. According to LLSV, the protection of private property rights in legal systems belonging to the French legal family is very low. At the margin, this lacking protection could be so severe that it dominates all other criteria implying that even firms that are familiar with the system would prefer to opt out of it into a system that they know less well. This hypothesis could be termed “*LLSV extreme*”. It would imply that no international contracts should be based on French law because even French firms – or more generally: firms from countries belonging to the French legal tradition – prefer to opt into other substantive laws. They thus expect that the higher transactions costs they need to incur due to their lower familiarity with other legal systems will be more than offset by the expected efficiency gains.

But LLSV do not need to imply this “corner solution.” It could be that some firms based in countries belonging to the French legal origin would prefer to stick to their legal origins whereas others would prefer to opt out. The number of contracts according to which French law is chosen as the applicable law then needs to be compared to the number of contracts one would expect to observe given that all parties strive to conclude contracts according to their own law. This hypothesis will be dubbed “*LLSV light*”.

Additional considerations that could have an impact on the choice of law are (1) the home-base of internationally active law firms. Our hunch here is that Anglo-American law firms are more important than the share of internationally traded goods and services from those countries would let one expect. This could be an advantage for the English law origin as we expect lawyers to advise their clients to choose a law with which the lawyers – and not the clients themselves – are familiar.

How to test these hypotheses empirically? There are a number of associations that have specialized in providing arbitration services to internationally active firms. We contacted quite a few of them asking for case statistics, and in particular for the chosen substantive legal systems. The answers were disappointing: Most of the organizations replied that they do not produce such statistics and that they were not able to produce them expressly for us. Table 1 gives an impression of the number of cases that these various organizations have received over the last dozen years.

Table 1: The Case Load of International Arbitration Courts

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
AAA	204	207	187	180	226	320	387	453	510	649	672	N/A	N/A
CIETAC	267	486	829	902	778	723	645	609	543	731*	684*	709*	850*
HKIAC	185	139	150	184	197	218	240	257	298	307	320	287**	280
ICC	337	352	384	427	433	452	466	529	541	566*	593*	580*	561*
JCAA	5	3	4	7	8	13	14	12	10	17	9	14	21
KCAB	30	28	33	18	36	51	59	40	40	65	47	38	46
KUALA LUMPUR	4	3	8	12	6	8	15	19	12	4	N/A	N/A	N/A
LCIA*	21	29	39	49	37	52	70	56	81	71	88	104	87
SIAC	7	15	22	37	25	43	67	67	55	56	46	41	51
STOCKHOLM	44	78	74	70	75	82	92	104	73	74	55	82	N/A
VANCOUVER*	44	52	54	40	57	41	49	60	88	88	71	76	84
VIENNA+	47	48	64	44	45	47	46	37	55	55	49	45	50

AAA - American Arbitration Association; CIETAC - China International Economic and Trade Arbitration Commission; HKIAC - Hong Kong International Arbitration Centre; ICC - International Chamber of Commerce; JCAA - Japan Commercial Arbitration Association; KCAB - The Korean Commercial Arbitration Board; Kuala Lumpur - Kuala Lumpur Regional Centre for Arbitration; LCIA - London Court of International Arbitration; SIAC - Singapore International Arbitration Centre; Stockholm - Arbitration Institute of the Stockholm Chamber of Commerce; Vancouver - British Columbia International Commercial Arbitration Centre; Vienna - International Arbitral Centre of the Austrian Federal Economic Chamber.

* The statistics include domestic as well as international arbitrations;** As a result of Severe Acute Respiratory Syndrome, the caseload for 2003 was down compared to 2002; N/A - not available; + cases completed.

Sources: Hong Kong International Arbitration Centre at http://www.hkiac.org/en_statistics.html and own modifications.

The only organization that provided at least some additional data was the International Chamber of Commerce in Paris which runs the International Court of Arbitration. This is why we present this court in a little more detail. Information is based on the Statistical

Report of the Court for the year 2003. The Court will only deal with conflicts that have an international and commercial background. In 2003, the Court had 114 members from 78 countries and met on 60 occasions, 12 times in plenary session and 48 times as a committee. Decisions on single cases are, however, not prepared by the court but by arbitrators. As the table already indicates, 580 cases were filed in 2003. 1584 parties were involved in these cases (implying that there were quite a few multiparty cases). Those parties came from 123 different countries, the highest number of parties coming from the U.S. and Canada (220). Next in line were France (127), Germany (112), Italy (92) and the U.K. (71).

Choosing the International Court of Arbitration is not equivalent to choosing Paris as a place of arbitration. In 2003, cases were heard in 47 different countries, the most frequently selected cities being Paris (112 cases), London (48 cases), Geneva (38 cases), New York (33 cases) and Zurich (26 cases). 82% of the contracts underlying the disputes referred to the ICA in 2003 contained a choice-of-law clause specifying the applicable law. In 80.4% of the contracts, the parties opted for a national law. The amounts in dispute ranged between less than 50 000 US dollars to more than one billion. Almost 35% of the cases involved amounts between 1 and 10 million US dollars.

According to the Statistics for 2003, “the laws of England, Switzerland and France” were the most commonly chosen ones. The Documentation & Research Department of the ICC informed me that this still held true in 2004. The percentage points are 24% for England, 20% for Switzerland and 19% for France whereas U.S. American and

Canadian Law was only chosen 10% of the time.⁶ LLSV code Swiss law as German legal origin. The Swiss Civil Code was indeed written by legal scholars from the German part of Switzerland who had been trained in Germany (Zweigert/Kötz 1996, 165ff.). Yet, subsequent to the French revolution, French influence had been considerable particularly in the Western and Southern cantons of the country. The *Code Civil* was valid in the cantons of Geneva and Berner Jura because they belonged to the French Republic. Even after the two cantons joined the Swiss confederation in 1815, the *Code Civil* remained valid there. When many of the cantons passed their own civil codes during the 19th century, the French *Code Civil* served as a model in many French speaking cantons such as Vaud, Fribourg, Valais and Neuchâtel, but also in Italian speaking Ticino (ibid., 102). Even though most observers seem to agree in classifying Switzerland as belonging to German legal origin, there is no doubt that French influence is not negligible.

Clearly, the numbers just cited are not in accordance with “*LLSV extreme*”. But how about “*LLSV light*”? In order to know we need a reference number of cases that we can compare these numbers with. A rather straightforward benchmark could look like this: every party to a contract will try to make its “home law” the law applicable to the contract. It was conjectured that the more powerful party could have an advantage here. Since we do not know anything about the relative powers of contracting parties, a reasonable assumption seems to be that all contracting parties have an equal chance of making the other party agree to its home law. Taking multiparty cases into account, the number of cases is then not divided by 2 (which we would do if all cases were two-party

⁶ The U.S. and Canada are reported in conjunction here because the numbers provided by the ICC are only available for both countries together. As we are interested in the choice of common law vs. civil law jurisdictions, this does not constitute a major problem as Canada belongs to the common law tradition (with the exception of Quebec).

In a study confined to the analysis of international distribution contracts, Corinne Truong (2001) finds choices of substantive laws that seem broadly in line with the more general figures provided here. She finds that civil law is chosen much more frequently than common law which might, however, be due to the fact that distribution was usually carried out in Europe. The rank order of the most attractive civil laws is French, Swiss, German, Italian, Spanish, Belgian, Dutch, Danish and Swedish. Note that Italian, Spanish, Belgian and Dutch laws are part of the French tradition.

On a more informal level, the secretary of the Vienna-based International Arbitral Centre of the Austrian Federal Economic Chamber has confirmed that more than half of the cases decided there use Austrian, German or Swiss substantive law.

cases), but by 2.73 in order to arrive at a benchmark. This number is the result of the division of 1584 (the number of parties engaged in ICC disputes in 2003) by 580 (the number of cases).

The statistical report of the ICC contains the number of parties ordered according to geographic origin. We thus know how many parties came from the four jurisdictions mentioned above and can divide the number by 2.73. The result is our benchmark, i.e. the number of cases that we would expect to be conducted under a substantive law of a nation-state given that no other factors, such as predictability, certainty or anything else play in.

Unfortunately, our information concerning the use of substantial law is highly restricted. We only know this number as a percentage for England, France, Switzerland and the US and Canada. This is why the benchmark is only calculated for these four jurisdictions. The comparison between the benchmark and the factually observed number of cases enables us to calculate a coefficient. Values of larger than one indicate that the substantive law of a country is chosen more often than was to be expected whereas values smaller than one indicate that the substantive law is chosen less often than expected.

Table 2

Country	Number of parties	Benchmark (= $p_i/2.73$)	Factually observed in%	Implied absolute number of cases	Coefficient
England	71	26	24	139	5.35
Switzerland	52	19	20	116	6.11
France	127	47	19	110	2.34
U.S./Canada	220	81	10	58	0.72

Sources: ICC 2003 Statistical Report, private communication, own calculations. For calculating the implied number of absolute cases, the entire case-load of the ICC (i.e. 580 cases) was taken as the base. On the other hand, only some 64% of all cases contain an explicit choice of national substantive law. Thus, we could also have calculated the numbers on the basis of 383 cases (i.e. 64%). It is, however, unclear what the numbers communicated by the ICC refer to. More importantly, changing the base does not change the quality of the results at all.

The results seem to indicate that Swiss law is most attractive, followed by English law, i.e. a law belonging to the common law family. If “*LLSV light*” were right, we would expect French law to receive a coefficient of smaller one which is not the case. What is even more astonishing is that U.S. law appears to be highly unattractive. Its coefficient is by far the smallest among the countries for which data are available. What is more, its coefficient is clearly below one, indicating that North American firms are opting out of their substantive law.

IV. Discussion of the Results

Of course, these results should be treated with caution: we only have data from one single arbitration court and we only have data for a very limited number of countries. Yet, the Document & Research Department of the ICC has confirmed that the year 2003 was not a year that was particularly disadvantageous to the U.S.. If anything, it was favorable to the U.S., as in 2002, only 7.7% of all cases dealt with by the ICC used U.S. law as substantive law; this would, *c.p.*, mean that the U.S. coefficient would have been 0.55 instead of 0.72.

Based on this natural experiment, we can thus conclude that *LLSV extreme* is clearly refuted by the available data. *LLSV light* is not confirmed by the available data either. Although English law was chosen more frequently than expected according to our benchmark, this was also the case for French as well as for Swiss law, with Swiss law being the most attractive although it has been heavily influenced by French law as discussed above. The data further seem to indicate that U.S. American law is perceived as unattractive by international businesspeople. The data are corroborated by anecdotal evidence according to which U.S. law is often perceived as bizarre.

It is noteworthy, however, that the performance of common law countries is pointing at different directions: whereas English law is chosen a lot more frequently than expected, U.S. American law is chosen a lot less frequently than expected. It would be interesting to know whether U.S. firms use this as a bargaining chip, i.e. agree on English law after it has become clear that their partners are not willing to consent on the use of U.S. American law.

Switzerland is clearly over-represented which might also be due to the construction of the benchmark. In its construction, it was assumed that the substantive law chosen is always the home law of one of the contracting parties. Yet, our theoretical considerations have led us to hypothesize that in cases of approximately equal strength of the contracting parties, they might just as well choose the substantive law of a third country. Here, Switzerland clearly has the advantage of being small: due to its small population, the likelihood that one of the contracting parties is Swiss is lower than, say, the likelihood of finding a British, German or American at the negotiating table which means that Swiss law has a higher *a priori* likelihood of being chosen if negotiations get to this stage. On the other hand, laws of countries with a similar population size such as Austria are selected less frequently.⁷ One reason for this could be that the Swiss are able to work in a number of different languages and that law commentaries etc. are available in at least four languages (namely German, French, English and Italian).

One possible counterargument with regard to the figures could be that it is small wonder that French law was chosen so often given that the seat of the organization providing for arbitration services was Paris. For two reasons, this counterargument is, however, not convincing: (1) the choice of location and the choice of substantive law are not only uncorrelated on logical and judicial grounds, but also seem to be factually uncorrelated (Corinne Truong 2001). (2) The choice of Paris as the location of the arbitration organization indicates that the set of rules and procedures applied there seem to be what many arbitrators prefer over other organizations at other locations that could, in principle, also be chosen.

⁷ Additionally, both countries have traditionally been neutral.

V. Conclusions and Outlook

The hypothesis that countries with common law origins have a number of advantages concerning the quality of their government vis-à-vis countries with civil law origins was shortly presented and critically discussed. It was argued that if the common law is indeed better suited to structure business transactions, businesspeople would, if given the choice, prefer to conduct their transactions under substantive law of the common law family rather than of the civil law family. In international transactions, business people have precisely this choice. The choice factually used by them thus constitutes a natural experiment to test the hypothesis concerning all the claimed advantages of the common law.

The results presented here are based on cases conducted under the auspices of the International Court of Arbitration. They show that French law, which is regularly supposed to be the worst branch within the civil law family, is frequently chosen, just as is Swiss law that has been substantially influenced by French law. Moreover, U.S. American law is chosen less frequently than expected according to the benchmark here constructed.

These results can, however, only be preliminary. For future studies, broader datasets covering more countries, more arbitration organizations and longer time-periods are desirable. In addition, some additional variables could be of interest: it could, e.g., be the case that the average contract length has substantially increased over time which could be interpreted as an attempt of the contracting partners (or their attorneys) to reduce the number of contingencies and thus to reduce the likelihood of ever having to resort to a state-created substantive law. This would, of course, mean that the relevance of the choice of law has decreased over time.

On a broader scale, it is noteworthy that LLSV never tested the significance of legal origins for explaining variation in income and growth. Our own tests in conjunction with judicial independence (Feld and Voigt 2003, 2004) showed that only socialist legal origins have a significant (negative) impact on growth rates. This points towards the necessity to “unbundle institutions” as proposed by Acemoglu and Johnson (2003). It appears plausible that differences in public law are a lot more relevant than differences in private law if one wants to explain differences in the growth paths of different countries.

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