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2006

Institutions, History, and Economic Development

Kenneth W. Dam

Kenneth.Dam@chicagounbound.edu

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Kenneth W. Dam, "Institutions, History, and Economic Development" (John M. Olin Program in Law and Economics Working Paper No. 271, 2006).

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CHICAGO

JOHN M. OLIN LAW & ECONOMICS WORKING PAPER NO. 271
(2D SERIES)

Institutions, History and Economic Development

Kenneth W. Dam

**THE LAW SCHOOL
THE UNIVERSITY OF CHICAGO**

January 2006

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INSTITUTIONS, HISTORY, AND ECONOMIC DEVELOPMENT

Kenneth W. Dam^α

Max Pam Professor Emeritus of American and Foreign Law

and

Senior Lecturer

The University of Chicago Law School

Senior Fellow

The Brookings Institution

If one wants insight into how the developing world can attain the Rule of Law, one good place to start would be to ask how countries in today's developed world did it. Though the developed world now stretches well beyond the countries of Western Europe where the Rule of Law first arose, developed countries such as the United States, Canada and Australia—and in a less direct fashion, Japan—were blessed with a successful transplant of Western European legal institutions. Perhaps the Western European experience can provide insights into how this process of legal institutional development can succeed in developing countries where the transplant remedy is obstructed by historical, societal, or other differences from Western European nations. Western Europe, after all, was not blessed with a Rule of Law in the Middle Ages but successfully achieved it over a number of centuries.

The first step in this analysis is to recognize that Rule of Law institutions are not essential for economic activity (though they are relevant to economic growth). In every country goods and services are exchanged, usually against money. In fact, in some of the poorest countries, the level of economic activity in local marketplaces is intense, truly something to be marveled at. And yet this exchange takes place without law playing a significant role.

^α The author would like to thank for their assistance and insight Richard Helmholz of the University of Chicago Law School and Maria Dakolias of the United Kingdom Department of Constitutional Affairs as well as his research assistant at the Law School, Wonbin Kang. This working paper was written in preparation for a forthcoming book length study of the rule of law in economic development.

Let us consider the public market, or bazaar, the primary economic institution of the medieval world and even today a common sight in the developing world. After verbal agreement between seller and buyer is reached, the seller hands over the goods and the buyer hands over the money. The quid and the quo are exchanged simultaneously. But, as Greif put it, suppose the quid and the quo are separated.¹ They can be separated in time, as when the buyer promises to pay later but wants to take the goods with him. What will then give the seller confidence that he will be paid as promised? In the absence of law (or, as we shall see, some ongoing relationship between seller and buyer), the seller is likely to simply refuse to sell except against money pressed into his hand. The same problem arises where goods are to be made to order with the seller requiring advance payment.

These problems were compounded in the medieval world when the buyer and the seller were geographically separated. True, seller and buyer could negotiate in writing or through a traveling agent. But the separation in place meant that the goods would have to be produced and delivered before payment could be expected, the seller thereby taking what he might well consider an unreasonable risk that the buyer would change his mind. Or payment could be made before the goods were produced, in which case it is the buyer who took the risk.

In these cases, the quid and the quo were separated in both space and time. Of course, most goods were simply taken physically to distant bazaars where they were offered for sale. The problem for the seller in that situation was twofold. If he was cheated in the bazaar, he had to trust the local authorities to protect him and not to discriminate against him as a foreigner. And second he would normally have to choose some kind of agent to act for him. If the agent absconded with his goods or with the payment received in exchange, the producer's remedies might be limited.

These kinds of problems were acute in the Middle Ages, not so much within the city states that were the dominant economies of the time in Europe but whenever long distance trade had to be carried on.² The city states had domestic legal systems³, but they could not easily enforce contracts in which their citizens were cheated when selling or buying goods in distant city states. And so inter-city trade was limited. These kinds of problems extended beyond trade and its financing to purely financial contracts and insurance contracts, both of which necessarily had the same separation between the quid and the quo as the trade examples.

¹ Greif (2004a).

² Greif (2004b).

³ Smith (1928, p. 213–216).

Even where the parties were bargaining in good faith, the separation of the quid and the quo created the possibility that one party, however well-intentioned ex ante, would find it to his advantage ex post to reopen the bargaining or simply welsh on the deal. This incentive to renegotiate agreements after one party had performed, a common occurrence even today, can be referred to as ex post opportunism; it creates severe economic inefficiencies whenever an adequate legal system is not in place. In other words, the enforcement of contracts is important to assure that contracts will be performed voluntarily.

As we will see throughout this book, these kinds of problems exist across the entire spectrum of economic activities whenever a system of law is not in place or does not work effectively to give parties confidence that contracts will be carried out. This is the essence of the Rule of Law problem in many developing countries where the legal system does not, for whatever reason, work effectively.

Nevertheless, some trade can take place even though the quid and quo are separated if the party at risk has confidence in the performance of the other party. That confidence may come from the reputation of the other party, though that statement begs the question of how the requisite reputation can be created. Of course, if the parties have repeated transactions, confidence may be created because each party knows that a failure to perform will end the business opportunities between the two. (Readers familiar with the theory of games will recognize the repeated game phenomenon, which offsets the incentive for someone in a two-player game to defect.⁴) Similarly, if the parties have some other relationship, such as being members of the same family, that relationship may be sufficient to give the requisite confidence. Consider the success of the extended Chinese families spread across Southeast Asia in carrying on trade even across countries that did not yet enjoy the Rule of Law.⁵

Early European Substitutes for the Rule of Law: Boycotts and Reputation

In considering the evolution of long-distance trade in Europe in the Middle Ages, one must recognize, however, that even in that period some solutions had been found to these kinds of problems, at least in certain instances. The solutions, however, illustrate why a Rule of law is essential to the efficient functioning of a modern economy.

One early solution was the Community Responsibility System.⁶ Under this system

⁴ Baird et al (1994, p. 203).

⁵ Bardhan (2000, p. 219–220); Redding (1990).

⁶ The description of this System draws heavily on Grief (2004a) and earlier Greif articles cited therein. See also Greif (2004b).

city states (communities) would hold all members of a foreign community responsible when any member of that foreign community cheated, or failed to pay a debt to, a local citizen. If the foreigner refused compensation, goods of that foreigner's compatriots within the local community would simply be impounded for the benefit of the local citizen. In effect, the presence of a debtor's compatriots provided de facto collateral. The System worked because the debtor's community would be motivated, in view of its dependence on long distance trade, to force its own citizen-debtor to pay because trade opportunities would otherwise be limited by what amounted to a boycott by the creditor's community. The System worked for both trade in goods and for financial transactions.

The System was, however, imperfect. In a sense the sanction was too powerful. In the first place, impoundment of goods of all foreigners from a given city disrupted trade between the two cities, at least until the dispute was settled. Nearby city states therefore sometimes entered into treaties to regulate the implementation of the System, as in the Pisa-Florence Treaty of 1214.⁷ And the sanction was too strong in a further sense; it gave the local creditor less reason to investigate the creditworthiness of his counterpart foreign debtor before entering into the transaction.

Clearly third-party enforcement would have been preferable to the Community Responsibility System. But there was no appropriate third party available where the two communities were not subject to a common sovereign. Neither Italy nor Germany had a single ruler because they were not unified states. In England under the Normans a centralized legal system was created in Westminster covering the part of England subject to royal control through traveling judges, but it was a costly and uncertain form of third-party enforcement, and so the Community Responsibility System played a role in England as well.⁸

An effort was made in England to create an alternative adjudication system. The Statute of Westminster I of 1275 outlawed the Community Responsibility System among communities within England by declaring that "no stranger who is of this kingdom is to

⁷ Greif (2004a, p. 130, n. 58).

⁸ In 1166 "a system of sending royal judges from the center to go on circuit through the counties" was established." Danziger and Gillingham (2003, p. 186-187). In view of the common belief that in the Middle Ages only churchmen could read and write it is worth noting that the overwhelming majority of this new class of judges were laymen, men learned in a law which depended for its regular functioning upon documents. Everywhere they went these judges applied the same laws, a common law all over England, which is why the king who sent them out is commonly regarded as the founder of the Common Law." (p. 189) This practice was similar to "circuit riding" in the United States. In early U.S. Supreme Court history "riding circuit for justices meant bouncing thousands of miles over rutted, dirt roads in stagecoach, on horseback, and in stick gigs to bring the federal judiciary to the American communities strewn along the Eastern seaboard. More so than the representatives of the federal postal system, the justices appeared despite rain, snow, sleet, and the hazards of traveling." Baker (1976, p. 63)

be distrained ... for what he is neither debtor nor pledge for.”⁹ As a substitute, a voluntary registration system was established eight years later in which debtor and creditor could jointly register a debt, thereby allowing designated local officials to foreclose on the moveable property of the debtor in the case of nonpayment.¹⁰ This registration system was in effect a primitive mortgage or pledge system for the enforcement of contracts involving the separation of the quid and the quo.

Another medieval solution to the problem of the separation of the quid and the quo involved merchant guilds. In northern Europe, guilds, which already existed for other local purposes, developed a way of dealing with the mistreatment of their members operating outside the town of their origin. Some guilds created what amounted to a multilateral system of boycotting foreign communities whose citizens cheated, stole from or imprisoned guild members. This multilateral arrangement was one of the major features of the association of German towns and merchant communities (known as the Hansa or the Hanseatic League) surrounding the Baltic and North Seas and their tributary rivers.¹¹ Such a coordinated boycott was, for example, successful in forcing the Belgian city of Bruges to deal fairly with the German expatriate business community in that city.¹²

The example just cited involved boycotts, but other systems were adopted in the period prior to the nation state that were based not on boycotts but rather on reputation. Just as local traders within a town could rely on local knowledge and experience based on past trading (in other words on reputation), additional means were established to build on the reputation concept.

For example, Jewish traders, known as the Maghribi traders, operated in the area surrounding the Mediterranean in the eleventh century. The system they developed involved the use of foreign merchants acting as agents for merchants seeking to sell their goods in distant towns. The problem to be solved was how the foreign agent could acquire the reputation needed to be entrusted with the goods when ongoing communication between principal and agent was ruled out by distance and the primitive communications technology available to them. The level of knowledge of conditions—prices, customs duties and the like—in the agent’s town was not just asymmetric between principal and agent but often the principal would have no current knowledge at all.

⁹ Statute of Westminster I (3 Edw. 1), 1275, c.23. In *English Historical Documents: 1189–1327*, Volume III, 404. See also Moore (1985, p. 104).

¹⁰ Plucknett (1949, p. 138–143). The new system evolved from the Statute of Acton Burnell, 1283. In *English Historical Documents: 1189–1327*, Volume III, 420–422.

¹¹ Tanner et al. (1932, p. 216–247).

¹² Greif et al. (1994, p. 759–762).

The solution adopted by the Maghribi traders involved a means by which the agent could convince the principal *ex ante* that the agent would be honest *ex post*. The Maghribi traders formed what amounted to a coalition that promoted the level of knowledge and communication such that any cheating by an agent could be catastrophic to the agent's business; he could expect the knowledge of his cheating to become general among all Maghribi traders. Maintaining a reputation for honesty could be expected to result in favorable terms and conditions for the agent. The system worked because the Maghribi traders were a distinct social group not just within the trading community but within the Jewish communities of the Mediterranean world, a condition that promoted not just trust but the communication on which trust could be based. The system was thus built on a multilateral reputation mechanism.¹³

The Maghribi traders system was geographically localized in the Mediterranean world and disappeared by the end of the eleventh century. But a different system, also based on reputation, was being created in Northern Europe. This was the Law Merchant. It was not a system of law enacted by a legislature or handed down by a ruler, and therefore some scholars are reluctant to call it "law."¹⁴ But it worked! Trading communities, normally guilds, established their own private tribunals. The law they adopted to govern commercial transactions was initially rooted in the rules followed in the most developed European cities of the time, the Italian city states, and was more or less uniform across Europe. But it was private law established and applied by private tribunals. One can call it customary law, but it was custom of a different kind than the customary law applied in small communities across Europe for local matters such as inheritance.

The Law Merchant can be seen as based on reputation because it was created and applied by merchants and was more or less uniform across northern Europe. Any word that a Law Merchant decision had been flouted by a particular merchant would result in the destruction of that merchant's reputation for honesty and hence he would not be trusted in long distance trade or credit transactions. Moreover, the fact that merchants knew and applied this standard law meant that word of a decision could be communicated simply and could be expected to travel quickly. Moreover, the Law Merchant grew beyond simple sales to include credit, bills of exchange, insurance and other trade-promoting legal devices.

A system related to the Law Merchant was used to promote honesty and fair

¹³ Greif (1989).

¹⁴ See for example, Donahue (2004) and Kadens (2004). See also comments in Epstein (2004, p. 3), which states that "the debate is as much about the definition of law as it is about the historical origins and development of the Law Merchant itself."

dealing at fairs (in Champagne and elsewhere in Western Europe), which were one of the principal means of long distance trade during this period. At these fairs buyers and sellers met, normally once a year. A number of localities held fairs.¹⁵ We know that the fairs had means of resolving disputes that arose at fair time, and we have some detail about the Flanders fairs, which had their own legal system. Beginning in 1252, foreign merchants were exempted from trial by combat and from reprisals; only their personal goods could be confiscated, although imprisonment for debt was permitted. But the important point was that any case involving a merchant had to be judged within a week. Cases, once brought, could not be delayed or adjourned. In short, disputes were resolved before the parties left the fair. It seems likely that a defendant would find it difficult to leave earlier or, if he succeeded in leaving, ever to return in view of the power of the authorities to exclude merchants from fairs. Moreover, many towns sent consuls to fairs to represent their own merchants in disputes before fair courts.¹⁶ And some towns established their own courts at distant fairs: a Flemish guild court traveled with Flemish merchants to handle internal disputes among the Flemish merchants at fairs in England.¹⁷

The Nation State

The development of the nation state in Europe provided a means to solve long distance trade problems. These nation states were monarchies, and the monarch had not only the means to create courts that could coerce compliance with contracts but also some motivation to promote trade, which meant some incentive to treat foreign traders fairly.

With growth of nation states the problems of long distance trade began to be resolved but only to the extent that the parties were subject to the same government. However, even in England, which had an early start with the Norman conquest and the centralization of the English court system in Westminster,¹⁸ it took a long period for the legal system to evolve to support even the rudiments of what we take for granted as necessary for a modern economy, with secured credit, business enterprises in corporate form, and markets in shares. Moreover, the existence of a monarch with nominal sovereignty over large areas did not mean that the writ of his judges necessarily ran so broadly. One has only to read Shakespeare's historical plays to realize that the rebellion of regional nobility was a repeated occurrence and a constant preoccupation in England.

¹⁵ Pirenne (1937).

¹⁶ The foregoing paragraph is based on Postan et al. (1965, p. 132–137).

¹⁷ Moore (1985, p. 96–99).

¹⁸ Milsom (1969, 15–22).

In short, even with the rise of the nation state, the ability of a King's courts to protect long distance trade must have been largely theoretical for some centuries as justice remained mostly local.¹⁹ For example, even in a country as relatively centralized as France the law remained based on local custom for centuries and was not fully unified until Napoleon. And as long as justice was local, the temptation to favor local merchants over traders from distant parts, even merchants of the same kingdom, presented problems for the growth of long distance trade and the development of modern financial and insurance techniques. Flourishing foreign trade requires protection against discrimination in the enforcement of contracts and the protection of property.

Germany and Italy did not even become unified nations until the nineteenth century. Much as we may admire the legal systems of present day developed countries, those legal systems have evolved a great deal. Even England, which was perhaps the first European country to achieve geographical unity, had a number of competing court systems. These different courts might produce different outcomes in factually similar disputes. A prime example would be the difference between outcomes in Common Pleas, a common law court, and Chancery, a tribunal designed to "do equity" – in short, to provide a remedy not available at common law.²⁰ There were, moreover, various prerogative courts that enforced rules proclaimed by the King independent of Parliament or the common law in the exercise of the King's prerogative powers.²¹

Predation and the Rule of Law Dilemma

With the growing power of monarchs came not just court systems but also a new threat to the Rule of Law. The monarch himself might disavow his own contracts or seize property of a subject for his own purposes. Today we sometimes see in authoritarian regimes in the developing world what we may call predatory rulers. And predatory is exactly what a number of European monarchs were in earlier centuries.

Social scientists sometimes describe the resulting Rule of Law dilemma in the following terms. A ruler strong enough to enforce contracts and protect private property is also strong enough to take predatory action against subjects.²² If citizens cannot trust their government to keep its hands off their property, they are unlikely to invest as much,

¹⁹ In the twelfth and early thirteenth centuries "'pleas concerning the debt of laymen...belong[ed] to the crown and dignity of the lord king'" and therefore were nominally within the jurisdiction of the courts, but "'private agreements'" were "not customarily dealt with by the king's courts." Ibbetson (1999, p. 17).

²⁰ Hanbury and Maudsley (1989).

²¹ Berman (2003, p. 202–213).

²² Weingast (1993, p. 287).

at least in certain kinds of property. Investment in diamonds, jewelry and gold is still common in the contemporary world in countries where precisely this kind of fear holds back investment in wealth-creating property. Failure to resolve the dilemma can therefore not just impede economic development but stimulate counterproductive behavior by citizens of the country.

. The first conclusion to be drawn is that to resolve this fundamental dilemma takes time. Further, its resolution is likely to be an evolutionary process. Attempts to jump start the process can prove dead ends. For example, one of the ways in which rulers have sometimes tried to enrich themselves while still favoring economic development has been to create an alliance with chosen business interests. To take an illustration, Haber and his associates have shown that in the nineteenth and early twentieth centuries Mexican development took that form.²³ It is fair to say that Mexico, despite its proximity to a rapidly growing U.S. market, was held back by this coalition between autocratic rulers and what we might today call “oligarchs.”

That today’s developed countries have largely solved not just the quid and the quo problem but also the predatory ruler problem is not the result of the work of great legal scholars or brilliant legal architects. On the contrary, the transition to a Rule of Law state has in most countries been the result of an evolution over several centuries.

Legal Evolution in England

The evolution in England has been the best documented of these transitions. Although many people of Anglo-Saxon heritage romanticize English history, often jumping to the conclusion that the Magna Carta of 1215 created a Rule of Law state, the facts are rather different. In truth, the Magna Carta, or Great Charter, was more a partial settlement of a dispute between King John and the English barons.²⁴ Schama well captures the limited scope, yet immense promise for a future Rule of Law, of the Magna Carta:

No one should read the Magna Carta as if it were some sort of primitive constitution.... Inevitably, many of [its] prohibitions amounted to tax relief for the landed and armoured classes.... So, if the Magna Carta was not the birth certificate of freedom it was the death certificate of despotism. It spelled out for the first time, and unequivocally ... that the law was not simply the will or the whim of the king but was an

²³ Haber et al. (2004).

²⁴ Plucknett (1960, p. 66–88); Danziger and Gillingham (2003, p. 160-184)

independent power in its own right, and that kings could be brought to book for violating it.... All this, in turn, presupposed something hitherto unimaginable: that there was some sort of English ‘state’ of which the king was part (albeit the supreme part) but not the whole.²⁵

If the Rule of Law is in part about the protection of property, it is well to recall that Henry VIII, in seizing the monasteries, carried out one of the largest expropriations in history, surpassed perhaps only in the twentieth century with the advent of Communism in Russia. The monasteries, the accumulated physical manifestation of centuries of donations by the faithful, constituted “approximately one-fourth of the landed wealth of England.”²⁶

The dissolution of the monasteries thus provided the Crown with vast lands, which were gradually sold to finance the needs of the Crown and especially to finance wars.²⁷ Although the seizure of the monasteries was part of the struggle with Rome, the truth is that Henry VIII, as English Kings before and after, had to run his governments largely out of his own resources, in part because no one had enough confidence in the King or in their legal rights against the King to lend to him. Nevertheless, the Crown did have limited sources of public revenue. Kings successfully claimed the right to impose customs duties as part of the royal prerogative. Taxation was limited, often to what the King was able to coerce out of Parliament on special occasions. For example, the first Parliament of the first Stuart King, James I (1603-1625), granted him the power to impose additional duties on imports and exports in view of the debts run up on behalf of the Crown by Queen Elizabeth.²⁸

As for direct taxes, when Charles I became King in 1625, “Parliament refused to grant the usual lifetime taxes allowed to a new monarch, and Charles resorted to forced loans, imprisoning those who refused to give them.”²⁹ Perhaps as a consequence, the Stuarts expanded the practice of borrowing to finance wars, largely from goldsmiths and non-English lenders, but they destroyed the confidence of their creditors by failing to pay on time and sometimes by repudiating debts.

The showdown came after the restoration of the Stuart monarchy in the latter half of the seventeenth century. At one point Charles II defaulted on the debt in the famous

²⁵ Schama (2000, p. 162).

²⁶ Berman (2003, p. 209).

²⁷ Tawney (1941, p. 23–25). See also Rajan and Zingales (2003, p. 136, 141) and Maddison (2001, p. 91).

²⁸ Berman (2003, p. 213–214).

²⁹ Berman (2003, p. 215).

“Stop of the Exchequer” incident in order to free revenues for military purposes.³⁰ Stuart King James II desperately sought funding for the war against France but could not raise adequate funds. The resulting concatenation of decisive events that led to an alliance of convenience between Tories and Whigs to replace James II with the Dutch Prince of Orange (who became King William III) and his English wife Mary. These events had a series of legal byproducts that created the foundation for a Rule of Law in England.³¹ These fundamental changes are today called the Glorious Revolution, not just because they were essentially bloodless but also because they created a constitutional foundation for assuring that the English monarchy was no longer in a position to be predatory.³² Today social scientists refer to these changes as creating a “credible commitment” that English rulers would no longer take their subjects’ property without compensation nor repudiate their debts.³³

Among these changes were that the King could only spend from public funds what Parliament appropriated for that purpose. Some of the key steps in creating this new order were enacted by the Convention Parliament in the 1689 Bill of Rights. This famous document declared that “levying money for or to the use of the crown ... without grant of parliament ... is illegal,” thereby giving the legislature exclusive fiscal powers.³⁴ The King was now truly “King in Parliament,” not King separate from and in effect over Parliament.³⁵ The Parliament responded by voting an annual appropriation for the Crown.³⁶ By the end of William’s reign in 1702, the annual “civil list” appropriation specified in some detail what the money would be spent for.³⁷ When the Bank of England was created in 1694 (before it was given monetary regulatory duties as a central bank), it was intended to be an intermediary from whom the Crown might borrow, but it was

³⁰ Carruthers (1996, p. 122–127); Stasavage (2003, p. 63); and Dickson (1967, p. 43–45). As noted in Clapham (1945, p. 12), the “Stop of the Exchequer” was not a repudiation of debt but rather a suspension of interest payments.

³¹ Weingast (1997a).

³² The Glorious Revolution is conventionally dated 1688 when James II took flight to France and the future King of England arrived in England, but the decisive constitutional events awaited the meeting of the Convention Parliament in 1689; indeed they continued to the Act of Settlement in 1701, which established the proposition that Parliament would thenceforth determine the succession to the throne. See Plucknett (1960, p. 444–465).

³³ North and Weingast (1989, p. 803).

³⁴ Williams (1960, p. 28) and Maitland (1931, p. 309).

³⁵ Maitland (1931, p. 300). Dicey, relying on Blackstone, expressed the concept as follows: The King, the House of Lords, and the House of Commons “may be aptly described as the ‘King in Parliament,’ and constitute Parliament” and “Parliament thus defined has, under the English constitution, the right to make or unmake any law whatever; and, further, that no person or body is recognized by the law of England as having a right to override or set aside the legislation of Parliament.” Dicey (1893, p. 38).

³⁶ English History, Encyclopedia Britannica, Vol. 8, 507 (1970).

³⁷ Maitland (1931, p. 310).

specifically forbidden to lend to the Crown without consent of Parliament, thereby giving Parliament further leverage over the King.³⁸

Parliament also established the supremacy of its lawmaking, again in the Bill of Rights, by declaring illegal the “pretended power of suspending laws, or the execution of laws, by regal authority, without the consent of Parliament.”³⁹ A second almost parallel clause similarly made illegal “dispensing with laws, or the execution of laws, by regal authority.” “Dispensing” referred to the King’s prior practice of declaring certain statutes inapplicable to specified individuals whereas “suspending” referred to the declaration of statutes as inapplicable to all persons.⁴⁰ That this was not a unilateral statement by Parliament, but rather part of the bargain between the two political parties of the day, the Whigs and the Tories, and a bargain by them with the Crown is shown by an amendment to the traditional Coronation Oath, in which William, unlike prior monarchs, swore to govern “according to the statutes in parliament agreed on, and the laws and customs of the same.”⁴¹ It is significant that, thereafter, “William and his successors duly refrained from any attempt to exercise a suspending or dispensing power.”⁴²

Parliament’s power vis-à-vis the Crown was made clearer in the 1701 Act of Settlement, which regulated the succession to the monarchy.⁴³ Thereafter, the monarchy became a statutory office in the sense not just that its powers were circumscribed by legislation but that even the person to succeed to that position would be determined, albeit perhaps indirectly, by the legislature.⁴⁴

More important still for the Rule of Law was a provision of the 1701 Act of Settlement that further defined the separation of powers by establishing the basis for an independent judiciary. The Act gave judges life tenure on good behavior,⁴⁵ thereby ending a pattern in which the Crown had threatened judges in key cases and dismissed them when threats failed.⁴⁶ Soon thereafter salaries of judges became fixed during their tenure, and they could be dismissed only if convicted of a criminal offense or by “the address of both houses” (similar to the U.S. impeachment process).⁴⁷ These major steps toward an independent judiciary supplemented earlier measures to limit or eliminate the prerogative tribunals controlled by the Crown. The Star Chamber had been used, until

³⁸ Giuseppi (1966, p. 10).

³⁹ Williams (1960, p. 28).

⁴⁰ Williams (1960, p. 28).

⁴¹ Williams (1960, p. 3) and Maitland (1963, p. 287–288).

⁴² Thompson (1938, p. 198).

⁴³ Plucknett (1960, p. 504).

⁴⁴ Dicey (1893, p. 41).

⁴⁵ Act of Settlement, III: 7. In Plucknett (1960, p. 463).

⁴⁶ Plucknett (1960, p. 464–466).

⁴⁷ Maitland (1931, p. 313).

abolished in 1641 during the Civil War,⁴⁸ not just to escape the safeguards and procedures of the common law courts, including the use of juries, but also to punish violations of royal proclamations and other crimes designated by the Crown—in short, crimes that were not created or defined by Parliament or by the common law courts.⁴⁹

The abolition of the Star Chamber and several other prerogative courts did not put an end to prerogative bodies. With the restoration of the Stuart monarch after the Civil War, James II, in 1686, created a new prerogative commission to govern the church and the clergy (with a view to reestablishing the dominance of the Church of Rome).⁵⁰ In response the 1689 Bill of Rights stated flatly that this latest effort to create a prerogative court as well as a “court of commissioners for ecclesiastical causes, and all other commissions and courts of like nature are illegal and pernicious.”⁵¹ This last provision was implicitly acceded to by King William in the new Coronation Oath by his acknowledgment that he must govern “according to the statutes in parliament agreed upon, and the laws and customs of the same.”⁵² The suppression of the prerogative courts was, as Weingast has observed, a major step by which “royal control over the judiciary was abolished, creating the ... ‘independent judiciary.’”⁵³

Other steps creating a modern separation of powers were designed to give Parliament independence from royal arbitrariness. Parliament, by the Triennial Act of 1694, now met in regular sessions, assuring that it could not be sent home for long periods when its majority was opposed to the Crown or kept in session for long periods when Parliamentary majorities favored the Crown.⁵⁴ Though the Triennial Act set a limit to the length of any particular Parliament and assured that the Parliament would meet at least every three years, the previously mentioned provisions on the King’s income and expenditures were perhaps more important because they changed the incentives so that it was now in the King’s interest to see that a Parliament was in session at least every year.⁵⁵ Parliament now controlled both the King’s income (or at least his use thereof)

⁴⁸ Maitland (1931, p. 302).

⁴⁹ For a general discussion on the Court, see Court of the Star Chamber, Encyclopedia Britannica 2004, Encyclopedia Britannica Online. See also Finer (1997, p. 1347).

⁵⁰ Maitland (1931, p. 312).

⁵¹ Williams (1960, p. 28).

⁵² Williams (1960, p. 3). A remaining prerogative body, the Court of Requests, was abolished by the end of the century. For a general discussion, see Prerogative Court, Encyclopedia Britannica 2004, Encyclopedia Britannica Online.

⁵³ Weingast (1997b, p. 220).

⁵⁴ Plucknett (1960, p. 526).

⁵⁵ Kemp (1957, p. 32–36). The Triennial Act states: “That from henceforth a parliament shall be holden once in three years at the least”; and “That from henceforth no parliament ... shall at any time hereafter be called, assembled or held, shall have any continuance longer than for three years only at the farthest.” Quoted in Williams (1960, p. 50). The Septennial Act of 1716 extended the period from three to seven years but did not change the principle of a maximum term for a particular Parliament and therefore

and his borrowings. Though the King still had his traditional sources of income (such as customs duties and the profits of lands he held personally), these traditional sources of income were inadequate. He had to turn to Parliament every year to supplement them; “Parliament, which from November 1685 until November 1689 did not meet at all, and met in only 75 of the entire 130 years of Tudor-Stuart reign, has met every year since 1689.”⁵⁶

In addressing the elements of the British evolution toward a Rule of Law it is important to consider two aspects: the constitutional structure and the underlying legislation that supported the growth of economic activity. The Glorious Revolution established the constitutional basis. The evolution from the abolition of the Star Chamber in 1641 through the Bill of Rights of 1688 and the Triennial Act of 1694 to the Act of Settlement of 1701 created a solid legal and constitutional base for the Rule of Law. In addition to cementing the independence of the judiciary, these developments fashioned a new relationship between the King, as ruler, and Parliament. Certainly the discretionary powers of the King vis-à-vis Parliament were drastically reduced: “of the discretionary powers exercised ... by the pre-Revolutionary English monarchy in relation to legislation, only one—the ultimate power of veto—remained by 1690 [and] after 1708 it was never resorted to again.”⁵⁷

Although the new structure was focused on the relationship between King and Parliament, one cannot say that by itself it created the kind of relationship between the ruler and the people that one associates today with the Rule of Law. To be sure, Parliament in some sense represented the people, and one can certainly say that protection of Parliamentary power served to protect the people. Of course, one should not confuse the resulting structure with “democracy” in view of the severe limitations on the voting franchise. But the same objection can be made to the system created by the U.S. Constitution of 1787. Both the English and U.S. systems represented a balance between legislative and executive powers, providing an answer to the predatory ruler problem, and a further balance achieved through an independent judiciary.⁵⁸ In the case of England the Glorious Revolution provided a strong base for later enjoyment of the fruits of the industrial revolution and for an economic evolution that made England arguably the wealthiest country in the world for a considerable period of time.

elections and turnover. Kemp (1957, 39–40). Meanwhile, as the text explains, Parliamentary control over the King’s income and expenditures assured that there would be annual Parliamentary sessions.

⁵⁶ Berman (2003, p. 227).

⁵⁷ Holmes (1993, p. 222).

⁵⁸ The Act of Settlement of 1701 did not provide security of tenure to judges during the lifetime of the appointing King. This exception was eliminated in 1761. Klerman and Mahoney (2005, p. 11–12).

Assessing the Glorious Revolution

The Glorious Revolution has been celebrated by economists largely for its role in enabling the British Crown to borrow to finance wars. A broader and ultimately more important perspective, however, concerns the creation of a Rule-of-Law state, which has broader development implications.

The large volume of recent studies examining interest rates and other financial indicators in the period after the Glorious Revolution to determine the financial effects of the Glorious Revolution is important but somewhat beside the point. Interest rates fell, though there is debate about how soon, how much, and for how long they fell.⁵⁹ Certainly the creation of a new international debt market in English government securities was somewhat of a hit-and-miss affair.⁶⁰ But the ability of the English sovereign to borrow new money at all was noteworthy in view of the earlier behavior of the Stuart Kings. Especially remarkable was the ability to borrow to the extent of increasing the debt seventeenfold between 1688 and 1697.⁶¹ One reason was that Parliament greatly increased taxes, thereby cementing, in the famous phrase of North and Weingast, a “credible commitment that the Crown would not default.”⁶² A land tax was introduced that raised large amounts of revenue. But the important point was that the land tax was voted by the same landed classes that controlled Parliament, thereby signifying that Parliament was prepared to pay for the wars that were engulfing England.⁶³

The larger accomplishment for future centuries of these great constitutional events surrounding the Glorious Revolution was, as already noted, the creation of a functioning Rule of Law, the first in the world.⁶⁴ And these accomplishments paid off. English per capita GDP, already some 30-35 percent higher than French per capita GDP in 1700, grew 35 percent in the 1700-1820 period while French per capita GDP grew

⁵⁹ See Stasavage (2002) and Quinn (2001). See also, on the effect of judicial independence, Klerman and Mahoney (2005).

⁶⁰ Dickson (1967, p. 46–75).

⁶¹ Rajan and Zingales (2003, p. 137).

⁶² North and Weingast (1989).

⁶³ Stasavage (2003, p. 108). For the facts, but with a somewhat different interpretation, see Brewer (1989, p. 95–100). Commercial interests, particularly those engaged in Atlantic trade, also favored the constitutional changes, according to Acemoglu, Johnson and Robinson (2005, p. 562–566).

⁶⁴ The Dutch Republic has perhaps some claim to be the first Rule of Law nation state. Stasavage (2003, p. 55). Certainly it grew faster than England for a time after it became independent of Spain in 1579. Maddison (2001, p. 75). Maddison and North attribute this growth rate to its position in international trade rather than to its domestic political arrangements. Maddison (2001, p. 75) and North (1981, p. 152–154).

only 25 percent.⁶⁵ North gives credit to the rise of the power of Parliament that “caused the nature of English property rights to diverge from the Continental pattern.”⁶⁶

Perhaps the best way to explain the institutional advance over Continental countries is to emphasize that the Glorious Revolution took care of the predatory ruler problem. But in celebrating the Glorious Revolution’s achievements, we should not overlook the fact that much of what was required to protect property against other private parties had already been accomplished in part by the evolution of common law rules, which dealt especially with land and inheritance. Also important was Parliamentary legislation as well as acts of private contractual ordering by merchants enforced by the common law. An early work by North points to such seventeenth century developments as “the creation of the first patent law to encourage innovation; the elimination of many of the remnants of feudal servitude, with the Statute of Tenures; the burgeoning of the joint stock company, ... [and] the development of the goldsmith into a deposit banker issuing bank notes, discounting bills and providing interest on deposits.”⁶⁷

Well before the Glorious Revolution, English property law already constrained the English King in a way that the French and other Kings were not constrained. Under French law the sovereign owned subsurface resources. But the English sovereign had no such power. Nef observed that this was one factor in explaining how the industrial revolution came earlier to England than to France:

The tendency in England during the hundred years from 1540 to 1640 was not, as in France, for the sovereign to extend his authority over mining and metallurgy. Under the influence of decisions in the common-law courts, and under the pinch of financial necessity, the royal authority contracted at a time when the rapid expansion in the output of copper, lead, iron, and especially coal gave the mining and metallurgical industries a much greater importance in England than in France.⁶⁸

In short, the legal measures surrounding the Glorious Revolution taken together with earlier common law decisions and Parliamentary legislation established a set of rules protecting property rights and enforcing contracts, free from arbitrary actions of the

⁶⁵ Maddison (2003, Table 1c).

⁶⁶ North (1981, p. 156).

⁶⁷ North and Thomas (1973, p. 155).

⁶⁸ Nef (1940, p. 101).

Crown. These rules enabled Britain in the eighteenth century not only to enjoy faster growth of the economy but also led the way into the Industrial Revolution.⁶⁹

Constitutions

Although the Glorious Revolution is primarily to be seen as creating a constitutional structure, it is important to observe that it did not result, as most revolutions do today, in a single written document and certainly not one that those involved chose to call a constitution. Constitutions did not become fashionable until the U.S. Constitution nearly a century later. (And, of course, the British Constitution even to this day is not a single written document.)

Relations between the government and the people are now often thought of as a matter for constitutions. For that reason constitutional development is essential not just for the protection of human rights but rather also, as the English example shows, for economic development. That is one of the shortcomings of the Legal Origins literature, which focuses on only one side of the economic development question—the private law side—and pays less attention to the public law side. Public law concerns not just constitutions—where the influence of the U.S. Constitution with its separation of powers is an important if often overlooked element in nineteenth century economic development—but also the way in which the public bureaucracy is controlled, if at all, by an independent judiciary.

Constitutions can, of course, have a major impact on the Rule of Law, particularly in the realm of personal liberties and human rights. These latter subjects are beyond the scope of the present discussion, though certainly relevant to the protection of property because it is hard to visualize a system that does not protect people but does adequately protect property. Put differently, if a person's life and personal freedom are at risk, then that person's physical property can hardly be safe. Nevertheless, one can observe developing countries with rapid growth but without satisfactory human rights protections—China being a prototypical example.

One completely different constitutional issue that has some bearing on economic development is federalism. In some cases federalism can contribute to economic growth. Certainly allocating some governmental power to constituent units of a country, as in the case of the United States, acts as a constraint on abuse by the central government. And as Weingast has pointed out, federalism can also favor economic development by

⁶⁹ North (1981, p. 171–186).

preserving markets.⁷⁰ This possibility will be explored in a discussion of federalism in China in a later chapter. But perhaps as often, federalism creates barriers to economic development, as the case of Russia in the 1990s suggests.⁷¹ In any event, federalism is not essential to economic development, as the case of present-day still highly centralized France demonstrates.

Non-Constitutional Elements of the Rule of Law

For now it is important to return to the non-constitutional aspect of the Rule of Law, the part that is referred to when developing countries are urged to protect property rights and enforce contracts. On its face this is a simple dictate. But it is not an easy policy to implement. Worse still, it is a slogan, more than a directly implementable policy. Just as in the case of the public law side involving the relation between government and the people, achieving the property/contract Rule of Law goal in private and commercial law has proved to be more of an evolutionary process than a simple decision and legal drafting exercise.

One of the problems is that the apparently crystal clear injunction to protect property and enforce contracts is inherently ambiguous. To show why this is so, it is useful to review what the draftsmen of the French Civil Code had in mind when they set out to begin their work. We cannot get too far with our analysis if we start with the Legal Origins conclusion that French law falls short. After all, the French Revolution and the Code Civil were precisely about private property and freedom of contract.

Nothing reveals so clearly that those ideas are inherently ambiguous than to examine what the French code drafters had in mind. Indeed, what they had in mind is some ways unrelated to the modern day Rule of Law, not just in the literature of the Legal Origins scholars⁷² but also of the theorists of the Rule of Law, such as Friedrich Hayek.

Protection of property in the Napoleonic period meant predominantly an end to feudalism and thereby the subversion of the power of the aristocracy. The 1791 French Constitution, although it did not survive, perfectly reflects the revolutionary intentions: "... there is no longer nobility, nor peerage, nor hereditary distinctions, nor feudal

⁷⁰ Weingast (1995) and Weingast (1993).

⁷¹ Figueiredo Jr. and Weingast (2001).

⁷² The term Legal Origins refers to a series of articles emphasizing the differences between different national legal systems stemming from the origin of those systems, especially differentiating between English, French, German, and Scandinavian origins. See especially La Porta et al. (1998).

regimes....”⁷³ Feudalism in Europe meant originally a complex hierarchical system in which an ordinary owner’s interest was dependent on the interest of a higher-level person.⁷⁴ By the time of Napoleon it meant the aristocratic practice of primogeniture, which by assuring that only the eldest son inherited land assured the survival of landed estates in the same families generation after generation and hence the perpetuation of the aristocracy’s wealth and thereby its power.⁷⁵ Napoleon’s solution in the Code Civil was to require the division of property at death among all children.⁷⁶ A person with children could dispose of only one-tenth of his property by will.⁷⁷ The obvious purpose was revolution by evolution: over several generations the great landed estates would be divided and subdivided and the aristocracy would lose its prestige and power.

One perhaps not so minor detail is that the 1791 Constitution also stated that only one hierarchical feature from the past would not be abolished: “...nor any other superiority [was to be allowed] than that of public functionaries in the performance of their functions.”⁷⁸ This can be interpreted as a belief in the bureaucratic state, with an emphasis on the public sector; that particular revolutionary heritage may be more important historically than the Code Civil. Indeed, even without the exaltation of the public functionary, the draftsmen’s intent to eliminate all prior law had a similar consequence. Merryman concludes that even during the more temperate post-revolutionary days of the Civil Code, there was a sub-text that underlay the declared purpose of writing on a clean slate:

[O]ne reason for the attempt to repeal all prior law, and thus limit the effect of law to new legislation, was statism—the glorification of the nation-state. A law that had its origin in an earlier time, before the creation of the state, violated this statist ideal. So did a law that had its origin outside the state—in a European common law, for instance.⁷⁹

⁷³ Merryman et al. (1994, p. 446).

⁷⁴ Berman (1983, p. 303–332) and Lawler and Lawler (1940, p. 3–22).

⁷⁵ Smith (1928, p. 171–173).

⁷⁶ Smith (1928, p. 173).

⁷⁷ Merryman et al. (1994, p. 447), quoting from Konrad Zweigert and Hein Kötz. 1987. *Introduction to Comparative Law: The Framework I*, 2d ed., trans. Tony Weir. 82–85.

⁷⁸ Merryman et al. (1994, p. 446).

⁷⁹ Merryman et al. (1994, p. 449–450).

Thus, if the origin of public law may be at least as important as the origin of private law, this underlying theory of French constitutional arrangements with its background of glorifying the nation state and the public functionary may well be more important for economic development than anything one can actually read in the Code Civil.

One important fact is that it took a good long time to eliminate all aspects of feudal land ownership in the present developing world. Take Latin America as an example: It was not just that French private law was not adopted in Latin America for many decades after independence. In addition, even though French law may have been an influence, the French Code Civil was rarely adopted outright. Rather Spanish law and Roman law, perhaps more supportive of feudal ideas, played a role in Latin America. In doing so, this cafeteria approach helped to perpetuate the societal role of the descendants of the early Spanish and Portuguese settlers.⁸⁰ When we come to modern times, we should certainly not assume that the spirit and theory of the property changes wrought by the French Code Civil would determine the protection accorded by Latin American governments to newer forms of property, such as rights in intangible property or shareholder rights.

The same counterintuitive story about protection of property can be told about the French Revolutionary draftsmen's intentions with regard to "freedom of contract." What that phrase meant in practice was that certain limitations on contracts that came largely from the influence of the Church were invalidated. A prime example was the abolition of usury restrictions on contracts. If there was to be freedom of contract, then legal restrictions on the rate of interest could not be tolerated.⁸¹ But this element of French revolutionary law was later abandoned.

A final aspect of the Code Civil bearing on the Rule of Law is that it was drafted in the context of other changes designed to reduce the role of the judiciary to a mechanical interpretive role in order to avoid gouvernement des juges and assure the dominance of the legislature. The judges were simply to apply the enactments of the legislature to the letter, just as a bureaucrat would be expected to do. Whether a judiciary with such a limited role can assure the Rule of Law is an important question.

One can conclude that although at a superficial level, the emphasis on property and freedom of contract might seem to be the keystones of a move toward the Rule of Law, especially in the simple-minded modern "protect property rights" and "enforce

⁸⁰ For a general discussion on Latin American social and economic influences on rule of law issues, see Rosenn (1990, p. 20–30).

⁸¹ Herman (1984, p. 612–614).

contracts” version, the French Civil and Commercial Codes (and one could argue at greater length, civil law in general) do not necessarily equate to the Rule of Law. More is required.

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Readers with comments should address them to:

Professor Kenneth Dam
University of Chicago Law School
1111 East 60th Street
Chicago, IL 60637
kdam@law.uchicago.edu

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