COMPETITION BETWEEN NATIONAL LEGAL SYSTEMS: A CONTRIBUTION OF ECONOMIC ANALYSIS TO COMPARATIVE LAW

> When governments become sufficiently plentiful, and when the scope of laws matches the domain of their costs and benefits (that is, when costs and benefits are all felt within the jurisdiction enacting the laws), competitive forces should be as effective with governments as they are with private markets.[1]

A. Introduction

Three main tasks can be identified for comparative law. The first is to investigate differences between legal systems and, in particular, to distinguish between "real" differences, where the outcomes of the application of principles diverge between legal systems, and "superficial" differences, where similar outcomes are masked by the conceptual structures of the relevant systems. The second is to trace developments in the relationships between legal systems and thus to explore tendencies of convergence or divergence (in terms of "real" differences), noting that in some areas convergence may be required under international legal instruments. The third task is to explain and to evaluate such developments: why do systems converge or diverge? Is convergence desirable or undesirable?

The convergence issue has been the subject of an intense debate among comparative lawyers.[2] As regards the positive dimension, the majority view appears to be that, except in relation to the domain of moral or religious norms (e.g. family law), and at least as between jurisdictions at an equivalent stage of social and economic development, there has been a tendency for legal principles from different jurisdictions to converge.[3] Others believe that such convergence is superficial: apparent consensus on principles has been unable to overcome real differences emanating from divergent legal cultures.[4] So also on the normative dimension. The orthodox line is that to facilitate dealings with the law, particularly in the context of international trade, harmonisation is—with the exception of the moral and religious domain—desirable.[5] Conversely, the dissidents hold that the genuine transplantation of concepts from one legal

1. F. Easterbrook, "Federalism and European Business Law" (1994) 14 Int.Rev. Law and Economics 125, 127–128.

2. Cf. B. De Witte, "The Convergence Debate" (1996) 3 Maastricht J. European and Comparative Law 105.

3. W. Van Gerven, "Bridging the Unbridgeable: Community and National Tort Laws after *Francovich* and *Brasserie*" (1996) 45 I.C.L.Q. 507; and, more generally, K. Zweigert and H. Kötz, *An Introduction to Comparative Law* (2nd edn, 1987), pp.23–27.

4. Notably P. Legrand, "European Legal Systems Are not Converging" (1996) 45 I.C.L.Q. 52.

5. E.g. O. Lando, "Why Harmonize the Contracts Law of Europe", in P. Sarcevic (Ed.), *International Contracts and Conflicts of Law* (1990), chap.1; B. S. Markesinis, "Learning from Europe and Learning in Europe", in B. S. Markesinis (Ed.), *The Gradual Convergence:*

tradition to another is impossible[6] or at least produces unintended and unwanted consequences.[7]

This article aims to contribute to the debate with the aid of economic analysis. Implicit in the positive convergence assertion is the hypothesis that there is a link between the social and economic order and the evolution of legal principles.[8] Now, while the disciplines of history, anthropology and sociology have been invoked to study this link,[9] economic theory has been largely ignored. A serious attempt to remedy the deficiency has been made recently by Ugo Mattei.[10] His important pioneering work includes some major insights, but so far has not generated an overarching theoretical framework to explain the relationships between different legal systems. I focus on, and develop, one of Mattei's key propositions,[11] that competition between the suppliers of legal rules will significantly affect the evolution of law (Section B). In order to use this basic concept to predict and evaluate the relationship between national legal orders, I argue that it is necessary to distinguish situations in which legal rules can be envisaged as a homogeneous product and therefore convergences between jurisdictions are likely spontaneously to occur (Section C) from those in which it has heterogeneous qualities and convergence is less likely (Section D).

The normative issue is of immense importance to the current debate on harmonisation or subsidiarity in European law, but the contribution of comparativists to the debate has tended to be superficial because the costs and benefits of harmonisation are not investigated with any rigour and little or no notice has been taken of the rich economics literature on the question. In Section E, I address the issue, challenging the orthodox view of comparative lawyers, that convergence of national laws (at least in the business sphere) is invariably desirable and that, if necessary, it should be promoted by mandatory harmonisation.

B. Competitive Markets for the Supply of Law

If suppliers of a product or service have to compete with one another, consumers can choose according to the quality and price of what is offered. On certain

Foreign Ideas, Foreign Influences and English Law on the Eve of the 21st Century (1994), chap.1.

6. P. Legrand, "The Impossibility of 'Legal Transplants'" (1997) 4 Maastricht J. European and Comparative Law 111; "Against a European Civil Code" (1997) 60 M.L.R. 44.

7. G. Teubner, "Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences" (1998) 61 M.L.R. 11.

8. For a detailed examination of the hypothesis, see A. Watson *The Evolution of Law* (1985). He argues that though the initial impetus for convergence might arise from social and economic forces, the phenomenon is largely attributable to lawyers who find it convenient to imitate legal principles developed in other jurisdictions.

9. Zweigert and Kötz, *op. cit. supra* n.3, at pp.8–12.

10. U. Mattei, *Comparative Law and Economics* (1997), which contains a number of previously published papers on the subject. See also U. Mattei and F. Cafaggi, "Comparative Law and Economics", in P. Newman (Ed.), *The New Palgrave Dictionary of Economics and the Law* (1998), Vol.1, pp.346–351.

11. U. Mattei and F. Pulitini, "A Competitive Model of Legal Rules", in A. Breton *et al.* (Eds), *The Competitive State: Villa Colombella Papers on Competitive Politics* (1991), pp.207–219.

assumptions, that should mean that consumer preferences are met at lowest cost. The corollary is that monopolist suppliers will not necessarily meet consumer preferences and they lack the incentive to constrain costs.

These simple propositions can be applied to the supply of law within a single jurisdiction. Although the lawmaker in a nation-State would seem to have a monopoly over the supply of law as it affects citizens within the territory, nevertheless we can identify elements of competition which may constrain how the power is exercised.[12] First, and most obviously, if the lawmaker is a democratically elected legislature, there is competition *ex ante* to acquire that power. The election manifestos of the political parties contain legislative proposals and citizens express their preferences between such proposals by their voting behaviour.[13] The phenomenon can be likened to that in which a monopolistic franchise power to supply a public service is allocated by a system of competitive bidding, the competition serving (in theory) to ensure efficient price and quality.[14] Second, while constitutions normally determine the hierarchy of lawmaking powers of the legislature, executive and judiciary, there may be *de jure* or *de facto* some degree of competition between them. This may occur also between different court systems with overlapping jurisdictions[15] or between self-regulatory agencies exercising delegated lawmaking powers.[16]

More significantly for the purposes of this article, interactions with other jurisdictions may create external competition for the supply of law.[17] Theorists do not seem as yet to have developed a general model for the functioning of such competition,[18] but we may readily speculate on how this is likely to occur. If domestic industries competing in international markets find that their national legal system imposes on them higher costs than those incurred by their foreign competitors operating under a different jurisdiction, they will apply pressure on their lawmakers to reduce the costs. That demand will be strengthened by the threat of migration to the more favourable jurisdiction, assuming that there are no barriers to the freedom of establishment and to the movement of capital. As regards supply, lawmakers are likely to respond positively to the demand from domestic industries because pressure by the latter can have a decisive influence on

12. A. Breton, *Competitive Governments* (1996).

13. The analogy with ordinary product markets should not, of course, be exaggerated because, *inter alia*: (except for referenda) voters must express preferences for a package of proposals rather than for single proposals; there is no way of indicating the intensity of their preferences; and "contracts" between prospective legislators and voters are not legally enforceable. See A. Ogus, *Regulation: Legal Form and Economic Theory* (1994), pp.59–61.

14. H. Demsetz, "Why Regulate Utilities?" (1968) 11 J. Law and Economics 55.

15. The famous struggle between the English Chancery Court and its common law rivals had a very significant impact on the evolution of legal principles: T. Plucknett, *Concise History of the Common Law* (5th edn, 1956), pp.159–163, 589–595, 644–645.

16. A. Ogus, "Rethinking Self-Regulation" (1995) 15 Oxford J. Legal Studies 97.

17. Mattei, *op. cit. supra* n.10, at chap.4; S. Woolcock, "Competition Among Rules in the Single European Market", in W. Bratton, J. McCahery, S. Picciotto and C. Scott (Eds), *International Regulatory Competition and Coordination: Perspectives on Economic Regulation in Europe and the United States* (1996), chap.10.

18. For a model applicable to regulatory competition within the EU, see J.-M. Sun and J. Pelkmans, "Regulatory Competition in the Single Market" (1995) 33 J. Common Market Studies 67.

politicians' behaviour.[19] Lawmakers will also be motivated, particularly in small countries heavily dependent on international trade,[20] to attract firms from other jurisdictions and multinational corporations since that should entail increased investment, demand for labour and tax revenue.[21] Of course there will be many variables operating on decisions as to location, but it is reasonable to envisage that at the margins the nature of the legal regime and its costs may have a substantial impact.[22] If so, market actors perform an arbitrage function in respect of different legal regimes.[23]

As an alternative to physical migration, and to the extent that this is allowed by the private international law of their home jurisdiction, firms may be able to select the jurisdiction whose principles are to apply to their transactions or business.[24] The decision should reflect not only the perceived advantages of the national legal regime but also the legal expertise available in the jurisdiction and its potential for reducing transaction costs.[25] Although the chosen jurisdiction will not acquire the benefits associated with physical migration, it may derive revenue from taxes or charges arising from the legal connection[26] and there will be a marked increase in the income of its lawyers.[27]

The strength of these competitive pressures will, of course, crucially depend on the costs,[28] as well as the legal freedom, of mobility and choice of law. But we can observe a number of twentieth-century developments that have facilitated the process: the growth of international trade, multinational corporations and joint ventures; the globalisation of markets and the elimination of barriers to trade;

19. Woolcock, *op. cit. supra* n.17, at p.306. For the role of private interest groups in influencing legislation, see C. K. Rowley, R. D. Tollison and G. Tullock (Eds), *The Political Economy of Rent-Seeking* (1988) and, for a summary of the literature, Ogus, *op. cit. supra* n.13, at chap.4.

20. D. W. Leebron, "Lying Down with Procrustes: An Analysis of Harmonization Claims", in J. N. Bhagwati and R. E. Hudec (Eds), *Fair Trade and Harmonization*, Vol.1: *Economic Analysis* (1996), chap.2.

21. Law more favourable to individuals may also increase tourism to the relevant jurisdiction: J. G. Brown, "Competitive Federalism and Legislative Incentives to Recognize Same-Sex Marriage in the USA", in Bratton *et al.*, *op. cit. supra* n.17 at pp.271–274.

22. Woolcock, *op. cit. supra* n.17, at pp.305–306.

23. S. Picciotti, "The Regulatory Criss-Cross: Interaction Between Jurisdictions and the Construction of Global Regulatory Networks", in Bratton *et al.*, *op. cit. supra* n.17, at p.110; Sun and Pelkmans, *op. cit. supra* n.18, at pp.83–84.

24. L. E. Ribstein, "Choosing Law by Contract" (1993) 18 J. Corporation Law 247.

25. "There seems little doubt that English commercial law is highly regarded by foreigners, who regularly select English law to govern their contracts and agree to submit their disputes to the English courts even where the transaction has no particular connection with this country. That is no doubt an acknowledgment of the pragmatism of English law and its sensitivity to legitimate business needs and a tribute to the expertise of our judges and the efficiency of our systems for the resolution of commercial disputes": R. Goode, *Commercial Law in the Next Millennium* (1998), p.94. See also on Delaware as a chosen jurisdiction for corporate law R. Romano, "Law as a Product: Some Pieces of the Incorporation Puzzle" (1985) 1 J. Law, Economics and Organization 225.

26. 16% of the total tax revenue of Delaware is derived from incorporation fees: R. Romano, *The Genius of American Corporate Law* (1993), pp.8–9.

27. J. Macey and G. Miller, "Toward an Interest-Group Theory of Delaware Corporate Law" (1987) 65 Texas L.Rev. 469.

28. Including information costs: Sun and Pelkmans, *op. cit. supra* n.18, at p.84.

and, within private international law, the relaxation of control by the *lex fori*, as exemplified by the principle of free choice of law for contracts and extension of the recognition and enforcement of foreign law in domestic courts.

If, and to the extent that, competition between national legal systems emerges, we can predict that this will impact on the content of law. In response to the demand from market actors, national lawmakers will compare their own legal products with those available in competing jurisdictions; if the latter better meet the preferences of the actors, they will be motivated to adapt their products. In short, free movement in goods and services may be matched by free movement in legal rules.[29]

Hitherto such movement has been envisaged in terms of one national lawmaker importing, or imitating, rules from another jurisdiction. Exporting is another possibility. Governments may promote the foreign adoption of their own laws by providing assistance in the preparation of legislation and the training of lawyers.[30] Their motivation to do so may not be just a question of prestige, a traditional comparative lawyer's explanation for legal transplants.[31] It may reflect the anticipated benefit to national lawyers from the transplant and, perhaps more significantly, to market actors wishing to trade with, or establish joint ventures in, the foreign jurisdiction.

The above reasoning would seem to lead to the prediction that, as a result of competition, there will be some convergence of national laws, by the reforming State either accepting a "transplant" from another or emulating its legal principles. Meeting the demand of market actors by this kind of action is cheap in terms of information and administrative costs.[32] In fact, the situation is more complex as there are other variables relevant to the analysis.

First—and this is classic comparative law methodology[33]—we need to recognise that conceptual differences between national legal principles may mask functional similarities. Market actors may be indifferent to divergent legal formulations provided they lead to outcomes which match their preferences. It matters not whether a tort claim for pure economic loss will be rejected because there is "no duty of care" (English law) or because it is "*dommage indirecte*" (French law).[34] The result is the same:[35] the differences are "superficial" rather than "real".

29. J. M. Smits, "A European Private Law as a Mixed Legal System: Towards a Ius Commune through the Free Movement of Legal Rules" (1998) 5 Maastricht J. European and Comp.L. 328.

30. J. M. Smits, "Systems Mixing and in Transition: Import and Export of Legal Models: The Dutch Experience", in E. H. Hondius (Ed.), *Netherlands Reports to the Fifteenth International Congress of Comparative Law* (1998). For an account of how Dutch law has thereby been exported to countries in the former Soviet Union, see *idem*, pp.54–68.

31. Cf. R. Sacco, "Legal Formats: A Dynamic Approach to Comparative Law" (1991) 39 A.J.Comp.L. 343.

32. A. Watson, *Legal Transplants: an Approach to Comparative Law* (1974); I. Ayres, "Supply-Side Inefficiencies and Competitive Federalism: Lessons from Patents, Yachting and Bluebooks", in Bratton *et al.*, *op. cit. supra* n.17, at pp.241–242.

33. Zweigert and Kötz, *op. cit. supra* n.3, at pp.31–33.

34. E. K. Banakas (Ed.), *Civil Liability for Pure Economic Loss* (1996).

35. In a contractual setting, even a difference in outcome may of little significance, if the parties can consensually prescribe their preferred outcome: R. Coase, "The Problem of Social Cost" (1960) 3 J. Law and Economics 1.

Second, and as a corollary to this, the information and administrative cost advantages of convergence may prove to be illusory when account is taken of the institutional structure and legal culture of different jurisdictions.[36] The cost of accommodating a concept foreign to the domestic legal culture, such as the trust for French property law,[37] or good faith for English contract law,[38] may be too high.

Third, and most importantly, we need to explore in greater depth the nature of the demand for change in legal rules. It is wrong to assume that all market actors have the same preferences or that, even if they do, their demand will always prevail over that of other parties (including lawyers) who also are affected by the relevant law.

To clarify these issues, and in consequence to sharpen the predictions, I draw a distinction between homogeneous and heterogeneous legal products.

C. *Competition Relating to Homogeneous Legal Products*

Homogeneous legal products are those as to which there is unlikely to be a significant variation in preferences as between market actors in different jurisdictions. The best examples are to be found in "facilitative law", that area of law which provides mechanisms for ensuring mutually desired outcomes: contracts, corporations, other forms of legal organisations and dealings with property. The assumed preference is for the minimisation of legal costs[39] consistent with ensuring the outcomes desired by those involved in the transactions. Since, in relation to these areas of law, reforms lowering legal costs will generate gains to the actors but no losers (except those who gain from more costly law, notably lawyers), competition between jurisdictions, where effective, should drive national legal principles towards cost-minimising formulations. Systematic empirical validation of the hypothesis may be lacking but it is not difficult to identify developments which support it.

Take first corporate law. The readiness of continental European jurisdictions, in the mid-nineteenth century, to imitate the English introduction of limited liability may reasonably be attributed to competitive pressures.[40] More recently, studies of the large number of American firms reincorporating in Delaware clearly indicate that the minimisation of legal costs there was a major motivation and that other States have attempted to stem the tide by changes to their own corporate laws.[41]

36. "Traditional or cultural factors may be construed as real-world transaction costs and/or patterns of path dependency that resist the evolution towards efficiency": Mattei, *op. cit. supra* n.10, at p.121.

37. D. B. Walters, "Analogues of the Trust and Its Constituents in French Law from the Standpoint of Scots and English Law", in W. A. Wilson (Ed.), *Trusts and Trust-Like Devices* (1981), pp.117–136.

38. M. Bridge, "Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?" (1984) 9 Can. Business L.J. 385.

39. These include the costs of enforcing legal rights.

40. D. C. Perrott, "Changes in Attitude to Limited Liability—the European Experience", in T. Orhnial (Ed.), *Limited Liability and the Corporation* (1982), chap.5.

41. Romano, *op. cit. supra* n.25; W. J. Carney, "Federalism and Corporate Law: A Non-Delaware View of the Results of Competition", in Bratton *et al.*, *op. cit. supra*, n.17, at chap.5.

Next, two examples from contract law. In the 1970s English courts became aware that other jurisdictions had taken the lead in restricting the doctrine of State immunity, which prevented State organs from being sued even when acting in a commercial capacity. As a consequence of international competition, the judges felt compelled to adapt English law.[42] Reform may consist of the removal of procedural requirements the benefits accruing from which are exceeded by their costs. French contract law contains a traditional requirement that defaulting promisors should be given a formal notice (*mise en demeure*) of their default and that damages for delayed performance should run only from the date of such notice.[43] Characterised by one author as "*formalisme primitif*" and attributed to the moral value of "*patience*",[44] the requirement imposes unnecessary costs on commercial actors and unsurprisingly has been much attenuated by *jurisprudence*.[45]

We have already seen that, for institutional and cultural reasons, the costs of imitating foreign legal principles may be unduly high. In such circumstances, the foreign model may be accommodated only to the extent that it is recognised under the rules of private international law. In comparison with civil law equivalents, the Anglo-Saxon trust has proved to be a particularly cost-efficient device for certain financial transactions.[46] While jurisdictions of mixed civilian and common law heritage (e.g. Louisiana and Quebec) have assimilated the device, pure civilian systems have adopted the limited private international law approach.[47] Nevertheless, Mattei has felt able to conclude that the "[t]rust has obtained an easy and well-deserved victory in the competition in the market of legal doctrines".[48]

The above analysis suggests that competition between jurisdictions should lead to some convergence of legal principles relating to homogeneous products. But we must be careful to acknowledge the possibility that powerful interest groups may impede such developments.[49] Mobility between legal systems and freedom in the choice of law may undercut the rent-seeking potential which national law confers on interest groups.[50] Therefore they may seek to create barriers to competition by influencing the law reform processes.

Firms established in jurisdictions with more costly legal structures, and which have already invested resources in complying with such regimes, will not wish to

42. *Trendtex Trading Corporation* v. *Central Bank of Nigeria* [1977] Q.B. 529: see Goode, *op. cit. supra* n.25, at p.92.

43. Code Civil, Arts.1139 and 1146.

44. J. Carbonnier, *Droit Civil*, Vol.4 (17th edn, 1993), No.77.

45. *Ibid.* An English law equivalent is the softening of the requirement for consideration to support modifications to contractual obligations: J. Adams and R. Brownsword, "Contract, Consideration and the Critical Path" (1990) 53 M.L.R. 536.

46. F. Sonneveld and H. L. van Mens, *The Trust: Bridge or Abyss Between Common and Civil Law Jurisdictions?* (1992).

47. See, especially, the Hague Convention on the Law Applicable to Trusts and their Recognition, 1985.

48. U. Mattei, "Efficiency in Legal Transplants: An Essay in Comparative Law and Economics" (1994) 14 Int.Rev. Law and Economics 3, 10.

49. L. E. Ribstein and B. H. Kobayashi, "An Economic Analysis of Uniform State Laws" (1996) J. Legal Studies 131, 142–144.

50. Easterbrook, *op. cit. supra* n.1, at p.128.

lose the competitive advantage which they thereby acquire over newcomers. They can therefore be expected to resist cost-reducing reforms to the law.[51]

Lawyers constitute perhaps the most influential pressure group in relation to law reform.[52] Their impact on competition will, however, vary according to their function. Those engaged in long-term contracts with firms will, provided they are faithful to the interests of their clients, have the same motivations (whether to advance[53] or resist the competitive process) as those that employ them. To ascertain the interests of lawyers as a more general class of potential income-earners requires a careful investigation of their profit-making possibilities.[54] On the one hand, they can benefit from the increased demand for their services arising from firms migrating to their jurisdiction, or adopting it under choice of law principles. That would suggest a strategy both of facilitating the competitive process and of supporting cost-reducing law reform. On the other hand, once firms are established in the jurisdiction, lawyers benefit from constraints on competition and, if such constraints exist, from rendering the law more complex and costly.[55]

Barriers to competition can be erected, or maintained, by adherence to restrictive choice of law rules. For example, the European adherence to the rule that the law governing a company's existence and internal affairs should be that of its "real seat" (thus inhibiting freedom of choice) has been attributed to the fear of French authorities that chartering business would be lost to competing jurisdictions.[56] Lawyers may also gain by opposing the international harmonisation or mutual recognition of rules. In 1981 the Law Society of England and Wales opposed the Vienna Convention on Contracts for the International Sale of Goods on the ground, *inter alia*, that it would result in a diminished role for English law within the international trade arena.[57] The profit motivation for such opposition to cost-reducing reform proposals is often disguised by atavistic or parochial references to local legal culture.[58]

D. Competition Relating to Heterogeneous Legal Products

Large areas of law are not "facilitative" in the sense described above. Rather, they are "interventionist" in that they protect defined interests and/or supersede

51. *OECD Report on Regulatory Reform* (1997), Vol.II, chap.4.

52. See, generally, P. H. Rubin and M. J. Bailey, "The Role of Lawyers in Changing the Law" (1994) 23 J. Legal Studies 807.

53. For evidence as to how lawyers engaged by transnational corporations have been able to exploit differences in national regulatory regimes and hence perform an arbitrage function, see Picciotto, *op. cit. supra* n.23, at pp.104–109.

54. Macey and Miller, *op. cit. supra* n.27; Carney, *op. cit. supra* n.41.

55. M. J. White, "Legal Complexity and Lawyers' Benefit from Litigation" (1992) 12 Int.Rev. Law and Economics 381.

56. W. Carney, "The Political Economy of Competition for Corporate Charters" (1997) 26 J. Legal Studies 303, 315–318. Note, too, that in so far as judges are responsible for developing choice of law rules, they can be expected to favour formulations which benefit domestic lawyers: M. E. Solimine, "An Economic and Empirical Analysis of Choice of Law" (1989) 24 Georgia L.Rev. 49, 73.

57. R. G. Lee, "UN Convention on Sale of Goods: OK for the UK?" [1993] J. Business L. 131, 132.

58. Mattei, *op. cit. supra* n.48 at p.16.

voluntary transactions. This covers tort and regulatory law, but also those aspects of contract, property and corporate law which confer protection on parties assumed to be disadvantaged by processes of free bargaining, for example consumers, employees, tenants and (in some contexts) shareholders.

Such "interventionist" law creates winners (the beneficiaries of protection) and losers (the subject of legal obligations). If there is competition between national legal systems, what will happen? Both the potential winners and the potential losers will attempt to exert pressure on lawmakers for more favourable law. Success will be a function of the costs of obtaining information regarding differences between legal regimes, the costs of migration, the benefits to the chosen jurisdiction of attracting (or retaining) legal subjects and the relative power of actors to influence legal developments. In these terms we may expect potential losers (normally enterprises) to be more successful than potential winners (normally individuals) since they have lower costs of information as to legal differences, lower migration costs (individuals typically have cultural and family reasons for remaining within a jurisdiction); they can confer larger benefits on the chosen jurisdiction; and they can more easily organise into coherent and powerful pressure groups.[59]

The *apparent* predictable outcome is then, as with "facilitative" law and subject to the same caveats, a convergence of legal principles. But here, since this will be to meet the preference of those subjected to interventionist obligations, the consequence will be that the level of protection provided by the law will be reduced. This is the famous "race to the bottom" prediction.[60]

However, the alleged winner–loser dichotomy must be explored with greater care: if costs are incurred by losers under an interventionist law, who ultimately bears them? The answer is not simply shareholders of the firms subject to the regime, but also their employees and consumers of their products or services (the exact distribution of the burden will vary from case to case according to the degree of price elasticity in the relevant capital, labour and product markets[61]). Once the apparently clear dichotomy between winners and losers disappears and the diversity of interests involved becomes more complex, predictions of how lawmakers will be influenced become more difficult, given that the strength of the interested groups, including lawyers, will vary according to the political and constitutional structures in each country.

Let us, however, proceed on the (perhaps heroic) assumption that national lawmakers can be adequately informed on, and will faithfully attempt to meet, the aggregated preferences of their citizens. We can then recognise that interventionist law is a heterogeneous product: preferences may vary between countries, regions and localities as to the different combinations of the levels of legal intervention and of the price which must be paid for them. If this is the case, there

59. M. Olson, *The Logic of Collective Action* (1965).

60. W. Cary, "Federalism and Corporate Law: Reflections on Delaware" (1974) 88 Yale L.J. 663; P. P. Swire, "The Race to Laxity and the Race to Undesirability: Explaining Failures in Competition Among Jurisdictions in Environmental Law" (1996) 14 Yale J. Regulation 67.

61. S. Rea, "Regulating Occupational Health and Safety", in D. Dewees (Ed.), *The Regulation of Quality: Products, Services, Workplaces and the Environment* (1983), pp.127–128.

is no necessary expectation that competition between national legal systems will lead to convergence, since much will depend on national preferences regarding the level of protection.[62] And this would seem to be borne out by the wide divergencies of "interventionist" law, even within the European Union.[63] For example, French law has offered a high level of protection for road accident victims, compared with English law;[64] and German law has had more extensive regimes for consumer protection than those applicable in most European jurisdictions.[65]

The above reasoning presupposes that the costs as well as the benefits of legal protection are internalised to citizens within the boundaries of the national jurisdiction. The predictions alter if there are significant transboundary effects, that is, international externalities. We may use the paradigm example of pollution, but the arguments would apply *mutatis mutandis* to product liability and other instances of such externalities.

If the costs of pollution abatement are predominantly incurred in State A, but the benefits accrue mainly in State B, we may anticipate that competition between national legal systems will have the following consequences.[66] First, it will be in the interests of citizens in State A to press for a lowering of the relevant level of environmental protection, since they will gain and citizens in State B will lose. This will be accompanied by perverse incentives for firms in State A to export more of their pollution to State B than would otherwise be justified: for example, by locating discharges close to the frontier with State B, or by building higher chimney stacks. Second, firms in State B, competing with the polluting State A firms, will apply pressure on State B lawmakers to reduce pollution standards in that jurisdiction. Third, State A will be reluctant to facilitate private transboundary legal actions by pollution victims in State B, unless there are perceived to be reciprocal benefits arising from such a development.

These considerations may suggest that, where there are significant international externalities, there will be some convergence of national laws towards a lowering of protection.[67] Empirical support for the prediction is nevertheless weak: studies tend to show that "races to the bottom" are rare.[68] There would seem to be two principal explanations for this.[69] In the first place, we must

62. R. Van den Bergh, "The Subsidiarity Principle in European Community Law: Some Insights from Law and Economics" (1995) 2 Maastricht J. European and Comp.L. 337.

63. R. Van den Bergh, "Subsidiarity as an Economic Demarcation Principle and the Emergence of European Private Law" (1998) 5 Maastricht J. European and Comp.L. 129.

64. A. Tunc, "It Is Wise not to Take the Civil Codes too Seriously", in P. Wallington and R. Merkin (Eds), *Essays in Memory of Professor F. H. Lawson* (1986), chap.7.

65. A. von Mehren, "A General View of Contract", *International Encyclopedia of Comparative Law*, Vol.7, chap.1 (1977), paras.79–80.

66. W. E. Oates and R. M. Schwab, "Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?" (1988) 35 J. Public Economics 333.

67. R. B. Stewart, "Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy" (1977) 86 Yale L.J. 1196.

68. K. Gatsios and P. Holmes, "Regulatory Competition", in Newman, *op. cit. supra* n.10, at Vol.3, pp.271, 274.

69. For a fuller discussion, see R. L. Revesz, "Rehabilitating Interstate Competition: Rethinking the 'Race-to-the-Bottom' Rationale for Federal Environmental Regulation" (1992) 67 N.Y.U.L.R. 1210.

recognise that lawmakers will find it difficult and costly to target less stringent regimes on activities which generate significant transborder effects but little or no domestic effects. Second, there may be some benefits to firms in being established in jurisdictions with stricter regimes: the higher standards may generate technological improvements to processes which confer competitive advantages on the firms complying with them.[70]

The general conclusion to be drawn from this section is that competition between national systems will not necessarily lead to a convergence of "interventionist" law, since preferences as to the content of that law may vary significantly. The existence of transboundary externalities may alter this prediction, but empirical support for the "race to the bottom" thesis is relatively weak.

E. The Normative Dimension

As we have seen in the preceding sections, the normal processes of trade and the existence of competition between jurisdictions should lead to the convergence of principles in some areas of law. The main question to be addressed in this section is the desirability of more proactive harmonisation, whether this be by a mandatory unification measure, as imposed by European directives and international treaties, or by voluntary codes, exemplified by the output of UNIDROIT and the Lando Commission,[71] which serve as model laws that States are free to adopt or which may influence courts in the development of judicial doctrine.[72]

Comparative lawyers have been committed advocates for, and active participants in, both harmonisation processes, particularly the second.[73] Indeed it seems obvious that substantial benefits may be acquired thereby: those engaged in international transactions will incur reduced costs in acquiring information as to the governing legal principles and, if necessary, in enforcing rights and obligations. But the ready appreciation of these advantages often blinds commentators to the costs which unifying law may generate.[74]

Let us take first homogeneous legal products. As we have seen, competition between jurisdictions should spontaneously induce some convergence towards least-cost legal principles. The very process of evolution from a pattern of diverse laws enables jurisdictions to experiment with different legal arrangements.[75] Spontaneous convergence has the additional, and perhaps even more significant, advantage over imposed or more formal harmonisation that the evolution

70. Woolcock, *op. cit. supra* n.17, at p.318; J. Bhagwati and T. N. Srinivasan, "Trade and the Environment: Does Environmental Diversity Detract from the Case for Free Trade?", in Bhagwati and Hudec, *op. cit. supra* n.20, at pp.171–172.

71. O. Lando and H. Beale (Eds), *Principles of European Contract Law* (1995).

72. See further on types of harmonisation Ribstein and Kobayashi, *op. cit. supra* n.49 and Smits, *op. cit. supra* n.29.

73. Lando, *op. cit. supra* n.5; J. Baselow, "Un Droit Commun des Contrats pour le Marché Commun" (1998) 50 Rev.Int. Droit Comp. 7.

74. Van den Bergh, *op. cit. supra* n.62. See also Ribstein and Kobayashi, *op. cit. supra* n.49.

75. Woolcock, *op. cit. supra* n.17, at p.299; Ribstein and Kobayashi, *op. cit. supra* n.49, at pp.140–141. Both this, and the last, proposition are derivable from the Hayekian theory of law: F. A. Hayek, *Law, Legislation and Liberty* (1979); and see A. Ogus, "Law and Spontaneous Order: Hayek's Contribution to Legal Theory" (1989) 16 J. Law and Society 393.

towards common solutions should occur only where it is economically appropriate; that is, where the benefits of convergence exceed its costs.[76] Now, while the reduction in information and other costs of harmonising legal principles may be substantial, such benefits may be outweighed by the costs of formulating uniform principles, reaching agreement on, and subsequently adapting national legal systems to, them. And, as regards the latter, we should note that private law is more problematic than regulatory law, since it is generally deeply entrenched in national legal culture.[77]

Of course, as we have seen, private interest groups, particularly practising lawyers, may be able to obstruct the processes of competition between jurisdictions, thus impeding evolution towards economically justifiable common principles. Should that occur, the case for mandatory harmonisation is strengthened. At the same time, we should recognise that comparative lawyers have themselves an interest in the harmonisation process: it generates a demand for their services and confers on them significant non-financial utility, such as that derived from increased prestige and agreeable meetings in attractive locations! We may therefore expect comparative lawyers to promote harmonisation even when it is not objectively justifiable.

The arguments against harmonisation of heterogeneous legal products are, in general, even stronger. Here, as we have seen, citizens in different jurisdictions may have different preferences regarding the level of protection to be imposed and the price to be paid for it. Obviously, such preferences may be overreached, with attendant welfare losses, if the uniform legal principles are imposed on purely domestic arrangements. Even when harmonisation is confined to activities with an international dimension, selection of the uniform principle may involve the supplanting of one jurisdiction's preferences by those of another, an outcome which might be avoided through a principle of mutual recognition or by appropriate choice of law rules.[78] Arguments for the harmonisation of *minimum* standards of protection[79] stand on a different footing since this may proceed on the assumption of homogeneity of preferences: it is reasonable to infer that the citizens of all affected jurisdictions would agree on the relevant threshold.

There remain two oft-cited justifications for uniformity of legal principles: transboundary externalities and fair competition. We have seen that the ability of firms to export to other countries the harmful effects of their activities, while capturing the benefits of those activities for themselves and others in their jurisdiction, *may* lead to the promulgation of lax standards. This would appear to be the paradigm case for mandatory harmonisation,[80] and yet we should not rush to that conclusion without recognising that it is a costly exercise and that alternative, cheaper solutions may be available.[81]

76. Leebron, *op. cit. supra* n.20, at p.54.

77. Van den Bergh, *op. cit. supra* n.63, at pp.146–147.

78. Leebron, *op. cit. supra* n.20.

79. This is now the policy favoured by the European Commission towards harmonisation of regulatory standards: see J. Pelkmans, "The New Approach to Technical Harmonization and Standardization" (1987) 25 J. Common Market Studies 249.

80. Leebron, *op. cit. supra* n.20, at pp.55–57.

81. R. L. Revesz, "Rehabilitating Interstate Competition: Rethinking the 'Race-to-the-Bottom' Rationale for Federal Environmental Regulation" (1992) 67 N.Y.U.L.R. 1210; R.

The ideal alternative solution would be to offer to those affected in the receiving jurisdiction the level of protection which would meet their preferences if they had to pay the increased costs of complying with that standard. In the case of product liability this may be feasible. A tort claim made by victims in their own jurisdiction would be governed by the law of that jurisdiction,[82] and the cost of meeting such potential claims would be reflected in the prices charged by importers and retailers. The same would apply if the import and sale of the product were governed by regulatory standards imposed by the receiving jurisdiction. With transboundary pollution this solution would not be viable, since there is no direct way of internalising to the pollution victims the costs of higher environmental protection. It would be necessary for the application of the receiving jurisdiction's environmental law to the polluter—itself a problematic task—to be combined with a system of subsidies to offset the necessary abatement costs incurred by pollution exporters and financed, at least in part, by a tax on those resident in the affected State.[83]

Finally, there is the familiar assertion that diversity of interventionist legal principles can create non-tariff barriers to international trade and thus impede fair competition. I cannot in this article adequately address the broad and complex range of economic and non-economic issues which this justification raises.[84] I will limit myself to some general observations, suggesting that caution should be exercised in invoking this set of arguments.

In the first place, there is the traditional economic reasoning, dating from Adam Smith:[85] while laxer interventionist laws in one jurisdiction may confer a competitive advantage on firms subject to those laws, the consequence should be lower prices of the products and services available in the international market with welfare gains to those in the States of the industries whose prices have been undercut. The resources hitherto used for the latter can then largely be shifted to other, more productive uses. Subject to short-term frictional losses, the aggregate welfare consequences for both jurisdictions are likely to be beneficial. In other words, the problem—if any—is distributional rather than economic:[86] for the more general good, some losses will be incurred by the industries previously complying with the stricter laws.[87]

Second, if the argument is for harmonisation at a higher level of protection than that provided in some jurisdictions, why should the preferences of their citizens

Van den Bergh, M. Faure and J. Lefevere, "The Subsidiarity Principle in European Environmental Law: An Economic Analysis", in E. Eide and R. Van den Bergh (Eds), *Law and Economics of the Environment* (1996), pp.121–166.

82. P. Kelly and R. Atree (Eds), *European Product Liability Law* (1992), chap.17.

83. Bhagwati and Srinivasan, *op. cit. supra* n.70.

84. See especially Oates and Schwab, *op. cit. supra* n.66; D. Salvatore (Ed.), *Protectionism and World Welfare* (1993): Bhagwati and Hudec, *op. cit. supra* n.20; M. Trebilcock and R. Howse, "Trade Liberalization and Regulatory Diversity: Reconciling Competitive Policies" (1998) 6 European J. Law and Economics 5.

85. *The Wealth of Nations* (Ed. W. R. Scott, 1921), Book IV.

86. Judged by the Kaldor–Hicks measure of economic efficiency: cf. Ogus, *op. cit. supra* n.13, at pp.24–25.

87. Leebron, *op. cit. supra* n.20.

for lower standards at a lower cost be overreached?[88] One answer is that there may be legitimate doubts as to whether the law in fact reflects those preferences, but it is far from clear that foreign observers are in a good position to decide whether or not there is political failure of this sort. Another possible answer is that the standards may be so low as to infringe widely held perceptions of human rights. Rights may, in this instance, justifiably "trump" efficiency;[89] or the matter may, rather, be characterised as a negative externality, foreigners deriving disutility from observing the plight of victims in the offending State. In either case there is still the difficulty of determining the legitimate boundaries of human rights or the disutility function of foreigners.[90]

F. Conclusions

In this article I have explored some of the ways in which economic analysis can contribute to an understanding of some key aspects of the relationships between national legal regimes and thus provide an important methodology for comparative law. The predictive part of the analysis suggests that competition between jurisdictions will generate a tendency for national legal principles to converge in those areas of law designed primarily to facilitate trade. In contrast there is, in general, no reason to expect this phenomenon to apply to interventionist areas of law because national preferences regarding the level of protection are likely to differ. In relation to both areas of law, the case for institutionally led harmonisation is weaker than comparative lawyers tend to assume.

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88. A. K. Klevorick, "Reflections on the Race to the Bottom", in Bhagwati and Hudec, *op. cit. supra* n.20, chap.12.

89. R. Dworkin, *Taking Rights Seriously* (1977), chap.4.

90. Trebilcock and Howse, *op. cit. supra* n.84, at pp.14–15.

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