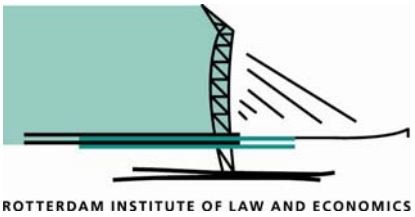

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A Law and Economics View on Harmonization of Procedural Law

Louis Visscher

Rotterdam Institute of Law and Economics

Erasmus University Rotterdam

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Louis Visscher[†]

Abstract

Even though there exists an extensive Law and Economics literature on the topics of procedural law and harmonization of law, very little has been written on harmonization of procedural law as such.
In this paper I first provide a brief overview of the economic approach to legal intervention, private enforcement and procedural law. Subsequently, I discuss the economics of harmonization of (substantive) private law. The traditional legal arguments in favor of harmonization (differences in legal rules between countries result in legal uncertainty and increased costs and therefore hinder cross-border trade, and harmonization would create a level playing field) turn out to be unconvincing. The economic analysis of law provides several arguments against harmonization (regulatory competition enables satisfying a larger number of preferences, it enables learning effects, (centralized) legislators suffer from limited information and the possible influence of interest groups should be taken into account) and in favor of it (the need to internalize interstate externalities, the desire to avoid a race to the bottom, decreasing transaction costs and profiting from economies of scale). These arguments have to be weighed in order to reach a conclusion on the desirability of harmonization
Such a weighing shows that there is, at best, a limited scope for harmonization of procedural law (and then only as an additional option). Harmonization would remove the possible learning effects and does not allow satisfying a larger number of preferences. The possible arguments in favor of harmonization of procedural law seem week, especially now procedural law is closely connected to the underlying substantive law. The only potentially strong argument is the reduction of transaction costs. It is ultimately an empirical matter if this argument outweighs the arguments against harmonization. The 2008 Oxford Civil Justice Survey in my view suggests that this is not the case.

Keywords: Harmonization, Law and Economics, Level Playing Field, Procedural Law, Race to the Bottom, Transaction Costs

JEL Classification: K41

[†] Associate Professor in Law and Economics, Rotterdam Institute of Law and Economics (RILE), Erasmus School of Law, Erasmus University Rotterdam.

1. Introduction

Even though there exists an extensive Law and Economics literature on the topics of procedural law and harmonization of law, very little has been written on harmonization of procedural law as such. In order to be able to assess this topic from an economic perspective, it is necessary to start with both separate issues. Without knowledge of the economic approach to procedural law and to harmonization, it is impossible to provide an answer to the question whether harmonization of procedural law should be striven for.
In Section 2 I will provide a brief overview of the economic approach to legal intervention in general and to private enforcement in particular. After that, in Section 3 I will discuss economic literature regarding (civil) procedural law. This Section will make clear that legal economists do not focus solely on the dispute resolution function of civil procedures, but also on its potential to 'produce' legal norms. These norms are not only relevant for the parties involved in the procedure, but also for other actors who may derive behavioral guidelines from the outcome of this case. This law-producing feature of civil procedures can be regarded as a social benefit. However, the parties involved in the procedure are likely more interested in their private costs and benefits. In economic terms, civil procedures may create a positive externality, so that the private incentives to sue are not perfectly aligned with the social optimal incentives.
In Section 4, I shift my attention to the economic approach to harmonization of law in general. Most economic literature on this topic concerns harmonization of substantive law, but the arguments which are developed pro and contra harmonization are also relevant in the current debate on procedural law. I will therefore discuss the arguments and I will provide examples from several fields of substantive law to make clear to what conclusions these arguments may lead.
In Section 5 I will turn to the issue of harmonization of procedural law. I will apply the arguments from Section 4 to procedural law, taking into consideration the economic role of civil procedure as sketched in Section 3.
In Section 6, I will conclude.

2. The Economic Approach to Law and Private Enforcement

2.1 Reasons for Legal Intervention

In the Law and Economics approach, legal intervention is primarily regarded as a way to try to correct various forms of market failure.[1] In the theoretical construct of full competition, i.e. a perfectly functioning market, social welfare is maximized. In such a market, parties transact without transaction costs on the basis of full information, so that entitlements per definition end up with the parties who value them the most. Actors incorporate all costs and benefits (both to themselves and to others) attached to their behaviour. They therefore only engage in an activity if the social costs are lower than the social benefits, so that their activities increase social welfare. Furthermore, due to competition, producers have to produce efficiently, because otherwise consumers will buy the product from a more efficient and hence cheaper competitor. Therefore, resources are not wasted (which would have lowered social welfare).

[1] See e.g. C.K. Rowley, 'Social Sciences and the Law: The Relevance of Economic Theories', (1) *Oxford Journal of Legal Studies* 1981, p. 401.

In reality, several departures from the market form of full competition exist. These market failures lower social welfare and form reasons for legal intervention. The first type of market failure is *market power*. In situations where market power exists, the producer(s) is (are) not forced to produce efficiently, because the necessary competition is lacking. Producers can produce inefficiently, can limit their output to below-competitive levels and can increase prices to above-competitive levels. This may result in a situation where consumers who value the product higher than its full costs, but lower than its increased price, will not buy the product anymore. This results in a loss of welfare. Furthermore, the costs of acquiring and maintaining market power as well as the reduced incentive to innovate lower social welfare. Competition law can be seen as a legal response to these problems, see for example the prohibition on cartel agreements (Article 101 TFEU) and the ban on abuses of dominant position (Article 102 TFEU).[2]

The second type of market failure consists of *negative externalities*. The behaviour of an actor may cause negative consequences for others, such as pollution or risk. If the actor does not bear these negative consequences, he does not incorporate these costs into his decision whether and if yes, how often to engage in his activity. His decisions, in other words, only take his private costs and benefits into account, but not the social costs and benefits. Engaging in the activity may therefore decrease rather than increase social welfare. Besides this problem of a too high activity level, the actor may also take inadequate precautionary measures to reduce the probability and/or the severity of the negative externalities. Various legal interventions may lead to internalization of the externality. For example, liability for harm caused by an actor may provide him with incentives to decrease the probability and/or magnitude of harm occurring, and/or it may incentivize him to reduce his activity level.[3]

The third type of market failure relates to the available *information*, which may differ between the transacting parties. If one party cannot perfectly monitor the other, the latter may decide to shirk, take excessive risks et cetera. This problem of *moral hazard* is relevant in, for example, insurance, where the insured may take less precautionary measures than the uninsured who themselves face the possible consequences of their behaviour. Comparably, consumers may become less careful in using products if they can sue manufacturers under products liability for losses caused by the product. This reduces social welfare, because people do not take the correct decisions regarding their behaviour. A second problem caused by information asymmetry is called *adverse selection*.[4] In a transaction, one party (for example the seller of a product) may know more about the quality of the product than the other party (the buyer) does. Given that the buyer does not know if the product is of high or low quality, he may only be willing to pay an average price. The seller, who knows the quality of the product, is only willing to sell products of at most average quality for this price. This means that the average quality of the products which are offered for this price is lower than the average of *all* products and hence the consumer lowers the price which he is willing to pay. This continues until only products of low quality are available. Hence, welfare increasing transactions may be forgone. Trademarks may ameliorate this problem, because they allow producers or sellers of high quality products to signal the quality of their product and they allow buyers to recognize products of high quality. Also consumer law can be regarded as a potential solution,

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[2] See e.g. R.J. Van den Bergh and P.D.N. Camesasca, *European Competition Law and Economics: A Comparative Perspective*, London: Sweet & Maxwell 2006, p. 43ff.

[3] See e.g. S. Shavell, *Economic Analysis of Accident Law*, Cambridge, Mass.: Harvard University Press 1987.

[4] See e.g. G. Akerlof, 'The Market for Lemons: Qualitative Uncertainty and the Market Mechanism', (84) *Quarterly Journal of Economics* 1970, pp. 488-500.

for example through information duties of the producer or seller, or through the requirement of conformity.
The fourth type of market failures is the fact that so-called *collective goods* are not produced in a private market. Collective goods are non-exclusive (it is not possible, or too expensive, to exclude someone from enjoying the good) and non-rivalrous (the use by a person does not affect the possibilities for use by others). Producers therefore cannot earn money with the good, because potential users who do not want to pay cannot be excluded, and their ability to use the good is not affected by the use by others. Information can be regarded as a collective good, which shows from for example downloading of music and movies and copying of texts. This may result in a lower than socially optimally amount of information being produced, because the producer may not be able to recoup the investments. Intellectual property law can be seen as a possible solution, because copyrights and patents give the producer of information a legal monopoly on the production and sale of the information, which enables them to recoup their investments.
Finally, in reality, transaction costs exist, which may prohibit welfare increasing transactions to take place. This implies that entitlements may not end up with the parties who value them the most, so that their initial allocation becomes important. Law plays an important role in this initial allocation. In addition, law can try to reduce transaction costs, for instance by establishing default rules in contract law. Only in case parties want to make a different arrangement than the default rules, they need to draw up a more extensive contract. Besides reducing the transaction costs, this also reveals private information of the party who wants to deviate from the default, which reduces the information asymmetry.

2.2 Private Enforcement

Section 2.1 showed the economic rationale behind various bodies of law. In order for these legal rules to fulfill their role, it is necessary that they are enforced and that violations are sanctioned. The expected sanction is the instrument which may induce the potential violator to refrain from his potentially welfare-lowering behaviour.
The economic literature regarding *optimal enforcement* analyzes under which conditions public enforcement may be better and when private enforcement is to be preferred. For example, anticompetitive behaviour can be targeted by the relevant competition authority in a public procedure, but alternatively the victims of this behaviour may start a civil procedure. Negative externalities may be handled through administrative law, criminal law and/or tax law, but also via private tort claims.
An important factor in the choice between public and private enforcement is the (un)availability of information regarding a norm violation and regarding the identity of the wrongdoer. If private parties have good information regarding these issues, it is not desirable to choose for (more expensive) public enforcement.[5] In a typical tort case, the victim knows that there was a norm violation and he also knows the identity of the wrongdoer.[6] This information is often not available to a public enforcer. Furthermore, the victim has an incentive to utilize his information, if he wants to claim damages. In case of a breach of safety

[5] R.J. Van den Bergh and L.T. Visscher, 'Optimal Enforcement of Safety Law', in: R.V. de Mulder (ed.), *Mitigating Risk in the Context of Safety and Security. How relevant is a rational approach?*, Rotterdam: Erasmus University 2008, p. 39.
[6] W.M. Landes and R.A. Posner, 'The Private Enforcement of Law', (4) *Journal of Legal Studies* 1975, p. 31; S. Shavell, 'The Optimal Structure of Law Enforcement', (36) *Journal of Law and Economics* 1993, p. 267.

regulation, private parties often lack the necessary information, so that public enforcement may be desirable. The public enforcer may build up expertise in the relevant area and may benefit from economies of scale in investigating possible violations.[7] The same holds for the area of competition law.[8] If representative actions are allowed, also private organizations may build up the necessary expertise or benefit from economies of scale.[9] Often a mix of public and private enforcement is needed to reach the best outcome.

A second relevant aspect in the choice between public and private enforcement is the question whether the enforcer receives socially desirable incentives in his decision whether or not to start a legal procedure. Generally speaking, private parties will be more interested in their private costs and benefits of litigation than in the public costs and benefits. Given that others than the parties involved may benefit from the outcome of a certain case (a point to which I will return in Section 3), private parties may prefer others to bear the costs of litigation. They may, in other words, want to take a free ride on the efforts of others. However, if too many people behave as free riders, there may be no civil procedure to start with, which would be an argument in favor of public enforcement. Furthermore, if the expected private benefits of a case are relatively small (for example because the wrongdoer is insolvent so that he cannot pay full damages or because every individual victim has only suffered a small loss), private parties may decide not to start a lawsuit (they then remain rationally apathetic). If insolvency is the cause of the problem, public enforcement may be called for. If scattered losses are the cause of the problem, besides public enforcement, allowing collective (damages)actions may be a solution. However, given that rational victims are not willing to pre-finance legal counsel, introduction of a form of result-based remuneration will be necessary then. Alternatively, allowing a victim to recover more than only his losses (hence, *punitive damages*) may overcome the problem of victims staying rationally apathetic.[10]

3. The Economics of Civil Procedures in a Nutshell

3.1 The Social Goal of Civil Procedures

In Section 2.1, the social goal of law from an economic perspective became clear: ameliorating the problems caused by different forms of market failure. Section 2.2 briefly discussed the choice between public and private enforcement of law and showed that under certain conditions, private enforcement is desirable. Viewed from this perspective, the main social goal of civil procedures is to enforce legal rules which address the issues caused by market failures. For example, collective actions in antitrust cases instigated by consumers or competitors of the infringer(s) serve the goal to bring the anticompetitive behaviour to a halt and to deter the defendant(s) and others from engaging in such behaviour. Tort cases for damages or injunctions equally aim to stop the tort from continuing and to deter this and other tortfeasors from subsequent tortious acts. They also may clarify the applicable behavioural

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[7] S. Shavell, 'Liability for Harm Versus Regulation of Safety', (13) *Journal of Legal Studies* 1984, p. 359.

[8] R. Van den Bergh and S.E. Keske, 'Private Enforcement of European Competition Law: Quo Vadis?', (3) *European Review of Contract Law* 2007, p. 471ff.

[9] See e.g. S.E. Keske, *Group Litigation in European Competition Law*, Mortsel: Intersentia Publishers 2010 (forthcoming).

[10] See e.g. W.P.J. Wils, 'Should Private Antitrust Enforcement Be Encouraged in Europe?', (26) *World Competition* 2003, p. 476 regarding treble damages in competition law and L.T. Visscher, 'Economic Analysis of Punitive Damages', in: H. Koziol and V. Wilcox (eds), *Punitive Damages: Common Law and Civil Law Perspectives*, Vienna: Springer 2009, pp. 219-236 for a general economic approach to punitive damages.

norms, e.g. because the court provides more information on how to concretize the negligence standard in certain circumstances. Contract cases in which damages or specific performance is being requested on the basis of breach of contract reinforce the norm that contractual parties (not only those involved in the procedure, but also others) should live up to their contractual obligations, or internalize the negative consequences in case they don't. Copyright and patent cases protect the legal monopoly which was granted to the holder in order to provide adequate incentives for production of information. Trademark cases protect the instrument with which producers can signal quality to overcome the problem of adverse selection. Hence, in all these cases, there is a clear social goal which is served: increasing social welfare by solving the problems caused by market failures.

However, as became clear in Section 2.2, the parties involved in civil litigation have private goals which may be ill-aligned with the social goals. A typical plaintiff in a tort case, for instance, likely is more interested in receiving damages than in deterring potential tortfeasors or clarifying the applicable behavioural norms. Likewise, private enforcers of competition law may be more interest in the direct (financial) outcome of the case than in deterring others from anticompetitive behavior. To put it in more general terms, the parties involved in a civil procedure may be more interested in the dispute resolution aspect of civil litigation, whereas the economic approach to civil litigation stresses a different function of civil litigation: contributing to the production of legal norms which help to tackle the problems caused by market failures. The legal approach is more *ex post*, looking back to the case at hand, whereas the economic approach is more *ex ante*, focusing on future behaviour. There are, of course, also cases which do not have merits beyond the case at hand, such as uncontested pecuniary claims. There the difference between private and social gains is much less important.

The fact that civil procedures may produce the above-described positive externalities (clearer guidelines for behavior, general deterrence, et cetera) implies that there may be a social value of litigation which goes beyond the private value of conflict resolution.[11] It is therefore important that civil litigation does not become too costly for potential plaintiffs (both in terms of money and time) because otherwise substantive law will not be enforced adequately and hence cannot provide the desirable incentives.

3.2 Minimizing Costs

Economic analysis of civil procedure centers on the issue how different procedures affect the sum of *direct costs* and *error* costs and how they influence the behaviour of the parties involved in the dispute resolution process.[12] The latter topic will be discussed in Section 3.3 below.

Direct costs are the costs of adjudication itself, so the time invested by the various actors involved (parties, lawyers, judges, (expert) witnesses), their wages, as well as the material costs (offices, office supplies, et cetera). Error costs emerge when wrong decisions are taken, because the substantive law then does not provide the correct incentives (for instance cases

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[11] See e.g. S. Shavell, 'The Fundamental Difference between the Private and Social Motive to Use the Legal System', (26) *Journal of Legal Studies* 1997, pp. 575-612 and S. Shavell, *Foundations of Economic Analysis of Law*, Cambridge, Mass.: The Belknap Press of Harvard University Press 2004, p. 283 ff.

[12] See for early literature e.g. W.M. Landes, 'An Economic Analysis of the Courts', (14) *Journal of Law and Economics* 1971, pp. 61-107 and R.A. Posner, 'An Economic Approach to Legal Procedure and Judicial Administration', (2) *Journal of Legal Studies* 1973, pp. 399-458. For an overview, see B.H. Kobayashi and J.S. Parker, 'Civil Procedure: General', in: B. Bouckaert and G. De Geest (eds), *Encyclopedia of Law and Economics, Volume V. The Economics of Crime and Litigation*, Cheltenham: Edward Elgar 2000, pp. 1-26.

where liability is warranted but due to e.g. problems of proving causation, liability is not imposed). There exists a trade-off between both types of costs. The more resources are invested in the procedure, for instance in hearing witnesses, the lower the probability of wrong decisions may become, so that direct costs increase while error costs decrease. The economic goal is to strike a balance between both types of costs so that the sum of error costs and direct costs is minimized. Quicker, cheaper procedures therefore have the benefit that they save on direct costs, but if the quality of the resulting rulings decreases, the overall assessment may still be negative. After all, if more errors are made, the behavioural incentives provided by the legal system are of a lower quality, which may result in more undesirable behaviour taking place. In addition, the direct costs of the legal system may increase after all, if lower-quality decisions (meaning, less in conformity with the desired outcome) are more often appealed than higher quality decisions. Another important possible drawback of cheap and quick procedures is that the number of legal claims will probably increase. After all, the price of litigation goes down (both in terms of money and of time) and the law of demand then predicts an increase in demand. Especially in cases where the social value of litigation is limited, such an increase is undesirable.

An important procedural 'instrument' with which both direct costs and error costs are influenced, is the burden of proof. From an economic point of view, many factors are relevant in deciding who should bear the burden of proof.[13] Obviously, the costs of producing evidence are important. If it is cheaper for the plaintiff to prove the presence of something (such as negligence, breach of contract, anticompetitive behaviour, existence of a debt, or more general the presence of a factor 'X') than it is for the defendant to prove the absence of X, then it makes sense to put the burden of proof on the plaintiff. However, also the *a priori* possibility that factor X is present should be included. If X is an unlawful act, given the assumption that most people do not behave unlawfully, the probability that X is present is much lower than the probability that X is not present. In that case, even if the costs of proving the presence of X may outweigh the costs of proving the absence of X, it still makes sense to put the burden of proof on the plaintiff. After all, if the burden of proof would be put on the defendant while it is unlikely that he has acted unlawfully, direct costs increase because the absence of X has to be proven in many cases, and error costs increase dramatically in the cases where the defendant cannot prove the absence of X. For example, if a plaintiff sues someone for damages for drunk driving, the costs of proving either drunkenness or soberness may be comparable (in both cases, a breath or blood test may be required) or may be even lower for the defendant (he can ask witnesses to testify about where he has been before the accident, while the plaintiff does not have that information). However, given that the vast majority of people do not drive while being drunk, it still makes sense to put the burden of proof on the plaintiff. It is also important to include available information which affects the *a priori* assessment of the probability that X is present. For example, if our defendant smells of alcohol, drives erratically and has bloodshot eyes, given that (the combination of) these factors occur much more often in case a person is drunk than in cases where he is not drunk, it makes sense to reverse the burden of proof.

Obviously, a procedural issue such as the burden of proof, as well as the level of certainty required, is strongly influenced by the underlying substantive law. I will return to this issue of the interconnection between procedural law and substantive law in Section 5.

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[13] See e.g. B.L. Hay and K.E. Spier, 'Burdens of Proof in Civil Litigation: An Economic Perspective', (26) *Journal of Legal Studies* 1997, p. 418.

3.3 Influencing Behaviour in the Dispute Resolution Process

The dominant economic model of dispute resolution (the 'expected value model of adjudication') evaluates the impact of procedural rules in different phases of the process. The parties involved in litigation make an assessment of the expected (private) costs and benefits in which they incorporate their beliefs on the probability of success. This assessment determines whether they file a claim, whether they proceed with a claim or drop it after new information becomes available during the dispute resolution process, whether they are willing to make or accept a settlement offer or whether they proceed to the actual trial and if yes, how much they spend on litigation.[14]

It goes beyond the scope of this paper to discuss these insights in detail, but the example of the way in which the litigation costs are divided over plaintiff and defendant may be instructive to illustrate the line of reasoning. Under the English Rule, the prevailing party recovers some or all litigation costs from the unsuccessful party while under the American Rule, each party bears its own expenses. Under the English Rule parties are expected to spend more on litigation than under the American Rule, now there is more at stake.[15] Furthermore, the higher the subjective assessment of success of the plaintiff, the more likely he is to sue. This effect is stronger under the English Rule, because a successful plaintiff under this rule does not bear the (full) litigation costs. This implies that the English rule creates a selection effect in the direction of high-merit claims. In addition, the more risk averse a plaintiff is, the less likely he is to sue. This effect is stronger under the English Rule because the stakes there also include the litigation costs of the other party. The effect on settlement is unclear. On the one hand, the 'greater expenditure effect' makes settlements more attractive, because litigation is expected to become more expensive. On the other hand, the tendency of parties to overestimate their probability of success reduces the incentive to settle under the English Rule. Empirical research suggests that this over-optimism effect dominates.[16] The overall impact on the total duration of claims in unclear. Information that becomes available during the procedure which shows a lower quality of the claim than originally expected will lead to a sooner dropping of the claim than under the American Rule, because the plaintiff runs the risk of having to bear the litigation costs of the defendant as well. The settlement stage is also expected to take shorter, because of the selection effect towards higher quality claims. However, cases which are not settled are expected to take longer in the adjudication phase due to the greater-expenditure effect.

The economic literature on the dispute resolution process also studies the impact of issues such as fee arrangements (no cure no pay, *quota pars litis*, no win less fee, et cetera) and possibilities of collective actions. All these issues turn out to be interrelated and they are also connected to other issues, such as the availability of legal expense insurance (after the event or before the event) or subsidized legal aid. The relevance of all these issues for this paper is

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[14] See e.g. S. Shavell, 'Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs', (11) *Journal of Legal Studies* 1982, pp. 55-81; R.D. Cooter and D.L. Rubinfeld, 'Economic Analysis of Legal Disputes and Their Resolution', (27) *Journal of Economic Literature* 1989, pp. 1067-1097; J.W. Hughes and E.A. Snyder, 'Litigation and Settlement under the English and American Rules: Theory and Evidence', (38) *Journal of Law and Economics* 1995, pp. 225-250; A.F. Daughety, 'Settlement', in: B. Bouckaert and G. De Geest (eds), *Encyclopedia of Law and Economics, Volume V. The Economics of Crime and Litigation*, Cheltenham: Edward Elgar 2000, pp. 95-158; Kobayashi and Parker 2000.

[15] A.W. Katz, 'Measuring the Demand for Litigation: Is the English Rule Really Cheaper?', (3) *Journal of Law, Economics, & Organization* 1987, p. 159 ff.

[16] E.A. Snyder and J.W. Hughes, 'The English Rule for Allocating Legal Costs: Evidence Confronts Theory', (6) *Journal of Law, Economics, & Organization* (1990), p. 366.

that procedural law may affect the parties involved in litigation in many interrelated ways. This implies that proposals for harmonization, which change the current procedural law, should be thought through very carefully, in order to avoid adverse effects. In addition, it is important to keep in mind that the incentives provided through the rules of civil procedure are also influenced by the underlying substantive law and issues such as the availability of legal expense insurance and subsidized legal aid, the question whether collective actions are allowed, et cetera. I will return to this issue in Section 5, where I will argue that the connection between substantive and procedural law is an issue which should be carefully considered in the debate regarding harmonization of procedural law. Before returning to that point, in Section 4 I will discuss the economic approach to harmonization of private law in general.

4. Harmonization of Private Law from an Economic Point of View

4.1 The Limited Value of the Traditional Legal Arguments in Favor of Harmonization

If one reads the economic literature regarding harmonization of law, it quickly becomes clear that the traditional legal arguments in favor of harmonization are critically assessed and that different arguments in favor of and against harmonization are applied.
One of the main legal arguments pro harmonization is that differences in legal rules between countries result in legal uncertainty and increased costs. This would hinder cross-border trade, because the costs of getting informed about the different legal systems may outweigh the gains from cross-border trade. And even if there would still be such trade, it has become more expensive due to these legal differences. In the words of the European Commission, regarding contract law:[17]

> 'For consumers and SMEs in particular, not knowing other contract law regimes may be a disincentive against undertaking cross-border transactions. This has been part of the rationale for some existing Community acts aimed at improving the functioning of the internal market. Suppliers of goods and services may even therefore regard offering their goods and services to consumers in other countries as economically unviable and refrain from doing so. (…)
> Moreover, disparate national law rules may lead to higher transaction costs, especially information and possible litigation costs for enterprises in general and SMEs and consumers in particular. Contractual parties could be forced to obtain information and legal advice on the interpretation and application of an unfamiliar foreign law. If the applicable law has been chosen in the contract, this applies to the contractual party whose law has not been chosen. (…)
> These higher transaction costs may furthermore be a competitive disadvantage, for example in a situation where a foreign supplier is competing with a supplier established in the same country as the potential client.'

Besides the fact that it remains to be seen if harmonized law indeed would result in more legal certainty (problems of different interpretation and application of the legal rules may still result in non-uniform law),[18] there is no empirical evidence that differences between legal systems indeed significantly impede international trade, nor that harmonization of law would result in more international transactions. Wagner for instance argues, regarding contract law, that

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[17] Communication from the Commission to the Council and the European Parliament on European Contract Law, COM (2001) 398 final, no. 30-32.
[18] Also see J. Smits, 'Diversity of Contract Law and the European Internal Market', in: J. Smits (ed.), *The Need for a European Contract Law. Empirical and Legal Perspectives*, Groningen: Europa Law Publishing 2005, p. 179.

large, multinational enterprises will not be deterred by differences between legal rules in the countries where they are active. They have experience with this problem and they will often use local lawyers and incorporate subsidiaries in the different countries to deal with the issue of different legal rules.[19] For small and medium-size firms this may be different so that in theory, the costs of dealing with different legal systems could indeed hinder international trade. However, Wagner states that in reality this may not be the case. He provides anecdotal evidence on small and medium-size enterprises that are active in many countries all over the world. More importantly, business associations representing small and medium-size firms during the consultation process on the Commission Communication of European Contract Law themselves did not regard full harmonization as a necessary tool to promote competition within the common market.[20] According to several responses, problems in the functioning of the internal market are more caused by language barriers, cultural differences, distance, habits, and divergence in other areas of law, such as tax law and, noteworthy, procedural law.[21]

A second traditional argument for harmonization is that it would create a 'level playing field'. After all, differences in legal rules between countries could create inequality in competitive conditions across member states, so it is argued. There are several reasons why this argument is not convincing. The first reason, being that different (groups of) people may prefer different rules so that a level playing field is not desirable to start with, will be treated in more detail in Section 4.2 below where the economic arguments against harmonization are discussed. In addition, in as far as the legal rules in a given jurisdiction hold for all actors in that jurisdiction, the playing field within every single jurisdiction already is level. There would only be a problem of unequal competitive conditions across member states if foreign actors are held to different, more stringent norms than domestic actors. In case of for instance tort law or contract law, this problem therefore does not exist. Furthermore, if the goal of harmonization is to remove the differences between legal rules of different countries altogether, this goal neglects that differences between countries are the basis of international trade to start with. Removing such differences may very well reduce social welfare. If legal differences enable for instance prices of goods of services to be lower in some jurisdictions, this will lower the prices on the international market, which also benefits those in the jurisdictions with the stricter rules.[22] Finally, harmonization of law will not result in a level playing field, because other aspects, such as infrastructure, wages, labor productivity et cetera will stay non-harmonized.

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[19] G. Wagner, 'The Economics of Harmonization: The Case of Contract Law', (39) *Common Market Law Review* 2002, p. 1014. Also see Smits 2005, p. 167.

[20] C. Ott and H.-B. Schäfer, 'Die Vereinheitlichung des europäischen Vertragsrecht – Ökonomische Notwendigkeit oder akademisches Interesse?', in: C. Ott and H.-B. Schäfer (eds), *Vereinheitlichung und Diversität des Zivilrechts in transnationalen Wirtschaftsräumen*, Tübingen: Mohr Siebeck 2002, p. 213; Wagner 2002, p. 1015; Smits 2005, p. 170.

[21] Smits 2005, p. 170.

[22] See e.g. A. Ogus, 'Competition Between National Legal Systems: A Contribution of Economic Analysis To Comparative Law', (48) *International & Comparative Law Quarterly* 1999, p. 417; R.J. Van den Bergh and L.T. Visscher, 'The Principles of European Tort Law: The Right Path to Harmonization?', (14) *European Review of Private Law* 2006, p. 515.

4.2 Economic Arguments Against Harmonization

1. Satisfying a Greater Number of Preferences

The starting point of the economic approach to harmonization is that legal diversity in principle is desirable, because different people may have different preferences regarding the goals of law, they may differ in wealth, in social norms et cetera. Uniform law, equally applying to everybody, is not able to take such differences into account. For example, countries with a higher national income per capita may prefer a higher safety standard or a different allocation of risks than less wealthy countries, for the simple reason that the level of safety and the allocation of risk influence the price of products and services, as well as the type of insurance necessary to cover those risks. Diverging social norms may impact what is regarded as desirable and acceptable behaviour, so that the legal norms governing this behaviour may differ per country or region.
This idea was first expressed by Tiebout, who illustrated it by the choice of people where to locate. Depending on their preferences, one community will be more attractive to person A, while another community may be more attractive to person B. Tiebout argues that 'the greater the number of communities and the greater the variance among them, the closer the consumer will come to fully realizing his preference position'.[23] Under certain conditions (among which full information about the different communities and full mobility of consumers), people will move to the community which is best for them. The parallel to the topic of harmonization of law is clear: by having different legal systems co-existing, a greater number of preferences can be satisfied, because people can move to the jurisdiction which best fits their preferences (which is called 'voting with their feet'). Alternatively, legislators may be induced to change the law if it turns out that competing jurisdictions meet the preferences of actors better.
Wagner extensively discusses this idea and the assumptions made. In reality, people do not have full information about different jurisdictions. Furthermore, moving from one jurisdiction to another is anything but costless and it is unlikely that people would move to another Member State because they prefer the legal rules there. However, in areas of law such as contract law were it is possible to choose the applicable law, it may still be possible that the existence of different legal systems facilitates satisfaction of a greater number of preferences (provided that foreign law is recognized and enforced in domestic courts).[24] In Wagners view, incomplete information about the different legal systems is still problematic, so that it is highly doubtful if choice of law can act as a substitute for voting with the feet.[25]

2. Enabling Learning Effects

A second possible advantage of legal diversity is that competition between legal systems enables learning effects.[26] Different solutions to similar problems and different interpretations of vague legal concepts may all yield valuable information of how legal rules influence human behaviour. It is therefore possible to learn from the solutions applied in other

[23] C.M. Tiebout, 'A Pure Theory of Local Expenditures', (64) *Journal of Political Economy* 1956, p. 418.
[24] Also see e.g. Ogus 1999, pp. 408, 416.
[25] Wagner 2002, pp. 1007-1011.
[26] See e.g. R.J. Van den Bergh, 'Toward an Institutional Legal Framework for Regulatory Competition in Europe', (53) *Kyklos* 2000, pp. 437, 438.

countries, which may help in finding a better solution in the domestic legal system.[27] Van den Bergh describes the example of competition law, where different instruments may be used to assess the anti-competitive effects of market concentration. The fact that different experiences exist, enables improving competition law.[28] It is also possible to 'import' legal concepts from other jurisdictions if they enable solving certain problems is a more satisfactory way. For example, the concept of 'loss of a chance' was already known in French law for a long time, before it was accepted in Dutch law.[29]
Ogus explains that a possible spontaneous convergence due to these learning effects has an important advantage over imposed harmonization: the former will happen if the benefits of convergence exceed the costs. Imposed harmonization on the other hand, with the focus on the possible benefits of cost reduction, may have more costs (formulating uniform principles, adapting national legal systems, et cetera) than benefits (reduction in e.g. information costs).[30] Obviously, this possibility of learning effects is lost in case of harmonized law. It is very doubtful if the centralized legislator is able to make up for this loss of learning possibilities by providing a higher quality of law. The next topic, limited information and the potential influence of interest groups, strengthens these doubts.

3. Limited Information of the Legislator and Influence of Interest Groups

There are additional reasons why legislation should take place at the lowest level possible, rather than at a higher level and hence also why competing national legal systems in principle are preferable to harmonized law (possible reasons why legislation should nonetheless take place at a higher level are discussed in Section 4.3). First, the 'local' legislator presumably will have better information regarding the local issues, problems and preferences than the legislator on a higher level. This implies that local regulation is better able than centralized legislation to deal with the issues and problems and to satisfy the preferences.[31]

The second issue is more complicated. The starting point is that regulators may be influenced by interest groups. Regulation hence does not by definition always serve 'the general interest' (whatever that may be) in an optimally balanced way. Interest groups, for example in the way in which they provide information to the regulator regarding the issue under regulation, may try to influence the regulator in such a way that the resulting regulation serves their private interests. As Wagner puts it: 'the democratic process is surrounded by and embedded in a world of intensive rent-seeking behaviour of societal groups, fighting to secure legislation furthering their particular interests'.[32] In order to try to reduce the possible problems caused by the influence of pressure groups, competition betweens different sets of regulations is preferred.
There exists a complication, though. Regarding the topic of harmonization of law, some groups will have an interest in keeping non-harmonized law while others on the contrary

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[27] Also see Wagner 2002, p. 1012.
[28] Van den Bergh 2000, p. 455.
[29] H.O. Kerkmeester and L.T. Visscher, 'Learned Hand in Europe: a Study in the Comparative Law and Economics of Negligence', *German Working Papers in Law and Economics* 2003, paper 6, p. 5.
[30] Ogus 1999, pp. 415-416.
[31] See e.g. M.G. Faure, 'How Law and Economics May Contribute to the Harmonisation of Tort Law in Europe', in: R. Zimmermann (ed), *Grundstrukturen des Europäischen Deliktsrecht*, Baden-Baden: Nomos Verlagsgesellschaft 2003, p. 38.
[32] Wagner 2002, p. 1000.

benefit from harmonization. This is the case irrespective of the answer to the question whether harmonization is desirable from a societal point of view. For example, academics specialized in their national legal system have different interests than academics specialized in international and comparative law.[33] The same is true for practicing lawyers in the different fields of law.[34] Furthermore, European bureaucrats, whose prestige and influence depends also on the level of centralization of lawmaking in Europe, have a private interest in harmonization. Finally, firms may have different interests. A firm located in a jurisdiction with a high level of consumer protection which has already spent resources on meeting those high demands will have an interest in avoiding harmonization which would lower the standard. After all, the fact that this firm already meets the demands is a competitive advantage when compared to potential newcomers who still have to invest.[35] On the other hand, firms who already meet the more demanding requirements may benefit from harmonization which would increase the standard, because this forms a barrier to entry.[36]
Hence, even though the impact of interest groups is in principle an argument in favor of competition between legal systems, one should not forget that interest groups may oppose harmonization also in cases where there are good arguments for it.[37] These arguments are discussed in the following section.

4.3 Economic Arguments in Favor of Harmonization

1. Internalizing Interstate Externalities

In Section 4.2, the issue of satisfying a larger number of preferences has been discussed, which resulted in an argument for decentralized rulemaking. This argument, however, assumes that all costs and benefits of the regulation under consideration are borne by those living in the relevant jurisdiction. If costs of the regulation may be externalized to actors in other jurisdictions, social welfare may decrease because in deciding on the regulation, not all costs are taken into account. If, for example, country A would have lenient rules regarding protection of the environment and if the pollution caused by actors in country A would mainly materialize in country B (for example because the pollution is transported there through the air or through rivers), then the joint welfare of country A and B may increase if both countries together decide on the appropriate level of environmental protection.
If voluntary negotiations between the countries involved do not result in the optimal outcome, for instance because property rights are not clearly defined or because parties behave strategically in negotiations, top-down harmonization may be required.[38] However, first it has to be assessed whether national laws are able to cope with the externality. For example, in case of product liability, differences in the level of consumer protection in principle could result in an interstate externality, if producers in a lenient state would sell their (unsafe)

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[33] Wagner 2002, p. 1012.
[34] Ogus 1999, p. 412.
[35] Van den Bergh 2003, pp. 448, 449.
[36] Faure 2003, p. 44.
[37] Ogus in this respect also argues that if interest groups could obstruct the process of competition between jurisdictions which could lead to spontaneous harmonization, mandatory harmonization may be required. Ogus 1999, p. 416.
[38] See R. Van den Bergh, 'Economic Criteria for Applying the Subsidiarity Principle in European Environmental Law', in: R. Revesz, P. Sands and R. Stewart (eds), *Environmental Law, the Economy, and Sustainable Development*, Cambridge, Mass.: Cambridge University Press 2000, p. 80 ff.

products in other countries. However, given that the manufacturer can be held liable according to the law of the importing state, there is no problem of interstate externalities and hence no need form harmonization after all.[39]
If national laws cannot cope with the problem adequately, regulation should take place on the level which is able to cover the area in which the externality exists.[40]

2. Avoid a 'Race to the Bottom'

The basic argument of the 'race to the bottom' is that competition between jurisdictions may lead to 'bad law'. The idea is that States, in deciding on regulation, may try to attract actors to their jurisdiction by offering rules which are attractive to them. For instance, by lowering the level of protection of employees, consumers and/or the environment et cetera, States try to attract firms, because this is to the benefit of the State (e.g. through more foreign investment and/or by increased tax returns). In competing with each other, States would continuously lower the standards of protection to become more attractive, which would result in very low standards which would only be to the benefit of firms. Centralization (including harmonization), so it is argued, may be necessary to avoid this problem.[41]
Besides the fact that it is difficult to argue on a theoretical level why competition between States would lead to adverse effects whereas competition in general is regarded positively,[42] empirical evidence for this alleged race to the bottom is also weak. Ogus offers some possible explanations. First, in order for the race to the bottom to occur in cases of negative interstate externalities, legislators have to find activities which generate 'significant transborder effects but little or no domestic effects'.[43] Second, it may be beneficial for firms to operate in jurisdictions with higher rather than lower standards, because this may induce them to technological improvements which provide competitive benefits. Ogus' first point can be generalized: a race to the bottom may only occur if States are able to attract industry with lenient rules. Faure discusses this issue for environmental law, where firms may locate in 'pollution havens' with low environmental standards. He shows, referring to a multitude of publications, that empirical support in this area again is weak: Pollution control costs are relatively low so that firms do not base their location decision on this issue; environmental regulation turns out not to induce existing firms to relocate, although location decisions of new firms may be influenced by it somewhat; other issues such as taxes, public services and the way in which the labor force is organized are much more important in the location decision. According to Faure, a 'race to the top' is more likely than a race to the bottom in cases of environmental liability, because States may choose to protect the interests of victims rather than industry and because more stringent rules may enable the States to sue for damages in cases of for example soil pollution.[44] Similar doubts regarding the alleged race to the bottom hold for the topic of product liability. If harm occurs in export markets, the firm is liable according to the rules of those jurisdictions, and not to those of the more lenient exporting state. Furthermore, it is doubtful whether States can charge the industry for using lenient tort law. This is an important difference with the often-used example of corporate law

[39] Van den Bergh and Visscher 2006, pp. 518, 519.
[40] Faure 2003, p. 38.
[41] Wagner 2002, pp. 1003, 1004; Faure 2003, p. 47; Van den Bergh and Visscher 2006, pp. 519, 520.
[42] See e.g. R.L. Revesz, 'Rehabilitating Interstate Competition: Rethinking the 'Race-to-the-Bottom' Rationale for Federal Environmental Regulation' (67) *New York University Law Review* 1992, p. 1236 ff.
[43] Ogus 1994, p. 415.
[44] Faure 2003, pp. 48, 49.

where a large proportion of American firms incorporate in Delaware. Here, Delaware receives incorporation fees, but in the field of tort law there is no comparable benefit for States offering attractive rules.[45] Of course, the mere fact that the firms locate in a jurisdiction already may be beneficial, because it may reduce unemployment, increase wages et cetera. This does not change the fact that empirical support for the race to the bottom argument is at best weak. Besides, even if harmonization would be justified by the danger of a race to the bottom, there still is the problem that not all States are equally strict in enforcing the regulation, so that differences between countries would still exist.[46]

3. Decrease Transaction Costs and Profit from Scale Economies

A last possible argument in favor of harmonization is that it may achieve economies of scale and it may reduce transaction costs. Scale economies exist if it is cheaper to have one (international) regulator rather than more lower-level regulators. This may be the case if the information that is required for regulation is not only relevant for one national jurisdiction, but also on a higher level, for example a group of countries or the entire European Union. Scale economies are likely important for the design of efficient rules of public law (such as product safety standards), but they may be much smaller, if not negligible, in other fields of law such as private law (including for example product liability).[47]
The transaction cost argument is closely related to the traditional legal argument of reducing legal uncertainty and reducing costs of international transactions, although that traditional legal argument is often set in the context of hindering cross-border trade. The line of reasoning is, in principle, quite simple. The currently existing differences in legal systems add to the costs of international transactions, for example of getting informed about the legal systems, of drawing different contracts for different countries, of litigation, et cetera. Wagner writes that 'legal diversity places a tax on European business, a tax that creates no benefits either for firms or for consumers but only benefits for lawyers'.[48] Even if firms would not be deterred from international transactions due to the higher costs caused by having to cope with different legal systems, there still would be such additional costs. Harmonization would reduce those costs, because one would not need to have knowledge of several different legal systems anymore. Again in the words of Wagner: 'Harmonization would eliminate a considerable part of the transaction costs (…) and thus benefit society as a whole by abolishing a tax on international businesses.'[49]

Ribstein and Kobayashi distinguish several types of costs, which are reduced by uniformity:[50]

- *Inconsistency costs*: an actor which is active in several jurisdictions will have to meet the requirements posed by these different jurisdictions. These requirements will likely differ,

[45] Van den Bergh and Visscher 2006, p. 520.
[46] See e.g. K. Gatsios and P. Holmes, 'Regulatory Competition', in: P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law Volume 3*, London: MacMillan Reference Limited 1998, p. 274.
[47] Van den Bergh 2000, p. 445; Van den Bergh and Visscher 2006, p. 521.
[48] Wagner 2002, p. 1014.
[49] Wagner 2002, p. 1017.
[50] L.E. Ribstein and B.H. Kobayashi, 'An Economic Analysis of Uniform State Laws', (25) *Journal of Legal Studies* 1996, p. 138 ff. Also see Ott and Schäfer 2002, p. 207 ff. and H. Wagner, 'Economic Analysis of Cross-Border Legal Uncertainty', in: J. Smits (ed.), *The Need for a European Contract Law. Empirical and Legal Perspectives*, Groningen: Europa Law Publishing 2005, pp. 31, 32.

which creates additional costs for the actor. Uniform law does not necessarily remove these costs, in as far as it is not applied and/or interpreted uniformly;

- *Information costs*: actors need to determine the law which applies in every jurisdiction in which they are active. Uniform law reduces these costs because it is more clear which law applies, but also the interpretation may be easier if judicial decisions regarding the correct interpretation become available. Smits argues that the information costs only decrease if all relevant rules are unified, because otherwise the actor still has to get informed about the other relevant, non-unified rules.[51] Ribstein and Kobayashi furthermore state that reduction of information costs is less relevant in situations where parties are able to choose the applicable law themselves;
- *Litigation costs*: under uniform law, parties no longer need to deal with issues regarding choice of law, and also do not spend resources on forum shopping. Smits adds the point that parties no longer have to obtain information about how to bring a claim against the other party. In my view, this is already 'covered' under information costs;
- *Instability costs*: if the law that governs a transaction changes, this forces the transacting parties to incorporate this change. According to Ripstein and Kobayashi, uniform law reduces these costs by focusing public attention on changes that reduce uniformity. Smits adds that information on changes in the uniform law will be more readily available than information on changes in a foreign legal system;
- *Externalities*: this issue was already discussed above. Decentralized regulators may be able to enact legislation that serves the interests of the people living in its own jurisdiction, thereby externalizing costs on people outside the jurisdiction. Uniform law avoids this problem, because the legislator has to take the interests of all constituents in all jurisdictions into consideration. Possibilities of 'voting with the feet' and choice of law however limit the relevance of this cost-reducing ability of uniform law;
- *Drafting costs*: uniform law making agencies can concentrate their resources on drafting particular laws and can hire experts in particular fields or in statutory drafting. Decentralized legislators on the other hand 'are often part-time generalists who have little incentive to spend time finely crafting legislation in particular areas and lack resources to hire advisors'.[52] Smits rightfully doubts whether this is an accurate description of the comparison between legislation on a European level and on the level of the Member States.[53]

Obviously, these benefits of uniform law have to be compared with the costs thereof. Ribstein and Kobayashi in this respect discuss that regulatory competition enables satisfying a greater number of preferences, that it enables learning effects (they call this 'innovation and experimentation') and that local legislators have better information regarding the local conditions.[54]

There are several reasons why the potential of uniform law to save on transaction costs should not be overestimated.[55] First, it is doubtful if harmonized law would indeed remove transaction costs to a large extent. After all, the harmonized rules will have to be translated

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[51] Smits 2005, p. 168.
[52] Ribstein and Kobayashi 1996, p. 140.
[53] Smits 2005, p. 169.
[54] Ribstein and Kobayashi 1996, pp. 140, 141.
[55] See R. Van den Bergh, 'Subsidiarity as an Economic Demarcation Principle and the Emergence of European Private Law', (5) *Maastricht Journal of European and Comparative Law* 1998, pp. 146-148.

into the different languages of Member States. The interpretation of the provisions might not be the same in all member States, especially if vague concepts are used, so that differences still exist.[56]
Second, the harmonization process itself causes transaction costs. Actors in all Member States have to switch from their own national legislation to the new, harmonized legislation. Smits argues that these costs are considerable. They include the costs of political decision making, of implementing the reform, and of adaptation to the new legislation (amending contracts, educating lawyers and judges, et cetera).[57] Especially if differences between national legislations are rooted in the respective legal cultures, harmonization will be difficult and costly.[58]

5. Harmonization of Procedural Law from an Economic Perspective

Looking at the role of civil procedures as discussed in Section 3 and the economic approach to harmonization which is treated in Section 4, it is now possible to bring both lines of reasoning together and to discuss harmonization of civil procedural law from an economic viewpoint.

The point of departure has to be, just as with any other type of law, that economists in principle prefer diversity, because it enables satisfying a larger number of preferences, as well as a learning process towards 'better law'. Hence, the subsidiarity principle from an economic point of view is not only relevant for substantive law, but also for procedural law.
An additional reason why especially harmonization of procedural law may be problematic is the fact that it is so closely connected to the substantive law of the different countries. After all, civil procedures are the instruments with which rights and obligations which result from substantive law are enforced. Differences in substantive law, legal culture, the relative importance of public versus private enforcement and social norms may have a strong impact on procedural law. For example, in countries where consumers are predominantly regarded as 'weak' parties that need protection against firms, procedural law may be used to strengthen this protection in the form of information duties for the defendant-firm, shifting the burden of proof, applying different statutes of limitation, et cetera to a larger extent than in countries where consumers are regarded as 'normal' parties in contractual settings who do not need additional protection. In tort law, the question whether certain risks are governed by strict liability or negligence, if proportional liability is accepted, what the required proof of for instance causation is ('more likely than not' or 'beyond a reasonable doubt'), which losses are regarded as recoverable (think about issues such as pure economic loss, pain and suffering damages, hedonic damages in fatal accidents), all influence the way in which a trial is conducted. A last example regards difference in cost shifting rules. As was shown in Section 3, these rules may impact civil procedures in many aspects, such as the decision to settle or sue, the resources spent on litigation, the quality of the claims being brought, et cetera. Cost shifting rules therefore have an impact on access to justice. The optimal rules on who ultimately bears litigation costs are strongly influenced by other issues, such as whether legal

[56] See e.g. Van den Bergh and Visscher 2006, p. 521.
[57] Smits 2005, p. 178. Also see e.g. D. Weber-Rey, 'Harmonisation of European Insurance Contract Law', in: S. Vogenauer en S. Weatherill (eds), *The Harmonisation of European Contract Law*, Oxford: Hart Publishing 2006, p. 233.
[58] Faure 2003, pp. 59, 60.

expense insurance and/or subsidized legal aid is available, if fee arrangements are possible and what types of collective claims are possible. Hence, certain aspects of procedural law may be closely connected to many other aspects.[59] In other words, there exists a strong 'path dependency' of procedural law. Harmonizing procedural law therefore might not only be even more difficult than harmonization of substantive law, it even is doubtful if harmonization of procedural law in these areas where substantive law differs, makes much sense. After all, the combination of substantive law and procedural law provides the behavioral incentives to actors. Procedural law is the instrument with which to effectuate claims arising from substantive law. Given the reservations Law and Economics has against harmonization of substantive law, it does not seem to make much sense to focus on harmonization of procedural law.

Summarizing, differences in substantive law which reflect differences in preferences, social norms, et cetera make harmonization of procedural law with which substantive law is enforced, problematic. In order to be able to satisfy more preferences, it is preferable to allow actors to choose which legal system they want to apply to their relationship. Hence, choice of law is in principle preferred over harmonization. This nicely connects to the presentation which the Secretary General of the Council of Bars and Law Societies of Europe gave at the 2008 Conference on Civil Justice System in Europe of the Institute of European and Comparative Law, where he stresses the importance of subsidiarity and mutual recognition.[60]

A possible 'middle ground' between the desire to harmonize on the one hand and the benefits of regulatory competition on the other hand can be reached by offering harmonized law as an additional choice. Especially in the debate on harmonization of contract law, this option is often mentioned as an attractive alternative.[61] It enables parties to choose a legal system which is the same (or at least comparable) in different countries, but it does not force them to do so if they prefer specific national legislation. The European Order for Payment Procedure[62] and the European Small Claims Procedure[63] provide examples of this idea in the area of procedural law. The fact that the proper functioning of the internal market, avoiding distortion of competition within the internal market and the need for Community legislation that guarantees a level playing-field for creditors and debtors throughout the European Union are all mentioned as rationales behind the regulation is not convincing from a Law and Economics point of view, as became clear in the above analysis of harmonization in general. However, Article 1 of the European Order for Payment Procedure states that it 'shall not prevent a claimant from pursuing a claim (…) by making use of another procedure available under the law of a Member State or under Community law' and article 1 of the European Small Claims Procedure states that it 'shall be available to litigants as an alternative to the procedures existing under the laws of the Member States'. This optional character nicely fits into the economic line of reasoning, because regulatory competition is actually increased by

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[59] Also see J.S. Parker, 'Comparative Civil Procedure and Transnational "Harmonization": A Law-and-Economics Perspective', *George Mason University Law and Economics Research Paper Series* 2009, Paper 09-03, p. 12.

[60] J. Goldsmith, 'Civil Justice Systems, Choice of Forum and Choice of Contract Law in Europe', available at http://denning.law.ox.ac.uk/news/events_files/Civil_Justice_Systems,_Choice_of_Forum_and_Choice_of_Contract_Law_in_Europe_-_Jonathan_Goldsmith_.pdf [last visited August 31, 2010].

[61] Although the danger exists that this 'European option' is chosen more often due to its prestige rather than its contents.

[62] Regulation (EC) No 1896/2006 of the European Parliament and of the Council of 12 December 2006 creating a European order for payment procedure, Official Journal of the European Union, L399/1.

[63] Regulation (EC) No 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European Small Claims Procedure, Official Journal of the European Union, L199/1.

adding an additional choice. Experience with how often this additional option is chosen, provides valuable information about the relative magnitude of the different costs and benefits associated with harmonization which were discussed above.

The risk of a race to the bottom does not seem very realistic in the case of procedural law, especially now actors cannot directly choose the applicable procedural law but have to do this via the 'detour' of choice of forum. Such a race would imply that countries try to attract actors with cheap and quick procedures. This in itself is no problem and could even be seen as a race to the top. After all, if the costs of civil procedures, as well as the time involved in it decrease, transaction costs would go down, which is desirable. The economic approach to civil procedures as discussed in Section 3 strengthens this point, because private enforcement of law is necessary in order to provide actors with the correct behavioural incentives. Barriers to civil litigation therefore are undesirable. This holds even stronger for small claims, where low barriers can already result in rational apathy. It is therefore positive that the European Small Claims Procedure provides a relatively inexpensive procedure, which results in a judgment that is recognized and enforceable in other Member State without the need for a declaration of enforceability and without any possibility of opposing its recognition.
Obviously, stimulating civil procedures should not go at the expense of the quality of the procedure. Low quality of civil procedures will itself result in costs (for instance the costs of appeal but also the costs of producing wrong behavioral norms), so that producing bad law is not attractive for countries anyway. In addition, it is doubtful whether countries would derive benefits from attracting international actors with 'bad' procedural law, besides stimulating their domestic legal profession. Furthermore, Article 6 of the European Convention on Human Rights poses several requirements on civil procedures, which further reduce the possibilities for a race to the bottom. The requirement of recognition and execution of foreign court rulings can also play a role in avoiding the race to the bottom problem. Hence, the race to the bottom argument is, to say the least, no more convincing than in the different areas of substantive law.

The possible problem of interstate externalities does not play a role in procedural law, especially now the civil procedure takes place between the parties involved. Of course there is a positive externality of civil litigation in the sense that it produces behavioural norms which are also valid to actors who are not involved in the procedure. This is, however, not an interstate externality which calls for harmonization. On the contrary, given that the procedure can help in clarifying legal concepts, fine-tuning vague terms et cetera, it is important that the procedure fits the underlying substantive law and that all relevant circumstances of the case, including local circumstances, customs et cetera, are dealt with. Procedures that are specifically designed to fit these circumstances will probably result in better rulings than procedures which are based on a common denominator of several different systems.

Given that harmonization of procedural law does not benefit from scale economies, especially now substantive law may differ per country, we have reached the last possible economic argument in favor of harmonization of procedural law: reduction of transaction costs. Clearly, on the one hand, harmonization of procedural law leads to a reduction of transaction costs, because lawyers from all countries involved no longer have to deal with and get informed about different legal systems. It is especially noteworthy that in the Commission Communication of European Contract Law, several responses stated that problems in the functioning of the internal market are not so much caused by differences in contract law, but more by language barriers, cultural differences, distance, habits, and divergence in other areas

of law, such as tax law and procedural law. Hence, procedural law is explicitly mentioned as a possible hurdle.
However, it is far from certain that the transaction cost saving by harmonizing procedural law outweighs its costs. Given that the underlying substantive law still differs, it is very doubtful if harmonized procedural law truly leads to uniform law, or if differences in interpretation would still result in substantial non-uniformity. Furthermore, the transition from the currently existing systems of national procedural law to the new harmonized law also causes transaction costs. As was explained in Section 4, it remains to be seen if the reduction in transaction costs due to harmonization outweighs the costs of harmonization, including losing the possibility of learning effects and of satisfying a larger number of preferences.
In the 2008 Oxford Civil Justice Survey of the Institute of European and Comparative Law it is examined 'to what extent businesses in Europe were influenced by their perceptions of national civil justice systems and contract laws when choosing the applicable law and the forum of litigation for cross-border transactions'.[64] From this Survey it becomes clear that many of the respondents find it very important (61%) or important (36%), when conducting cross-border transactions, to be able to choose the dispute resolution forum.[65] With the statement that variations in European civil justice systems deter the respondent's company from doing business in certain jurisdictions, 51% disagrees strongly, 25% disagrees mildly, 19% agrees mildly and 1% agrees strongly.[66] With the statement that such differences constitute, overall, a barrier to trade, 25% disagrees strongly, 35% disagrees mildly, 33% agrees mildly and 6% agrees strongly.[67] In my view, these results suggest that the transaction cost saving argument does not outweigh the arguments in favor of regulatory competition. Granted, the respondents are positive about the idea of a harmonized European civil justice system (36% very favorably, 40% favorably, 19% not very favorably and 4% not at all favorably), especially because it reduces costs.[68] However, only 22% would choose for the option of a European civil justice system which replaces national civil justice systems, while 25% would choose for this European system to be an additional choice. Most respondents (37%) would opt for a greater alignment of civil justice systems.[69]

6. Conclusion

Evaluated from an economic perspective, there do not seem to be many arguments in favor of harmonization of procedural law. In order to be able to learn from experiences and solutions in other jurisdictions, to meet more diverging preferences and to better connect procedural law to the underlying substantive law, clear rules regarding choice of law and regarding recognition and execution of foreign titles seems like a much better approach. In as far as 'best practices' exist which could also be used in other jurisdictions, regulatory competition enables bottom-up harmonization because other jurisdictions may incorporate similar solutions.

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[64] C. Hodges, S. Vogenauer and M. Tulibacka, 'Costs and Funding of Civil Litigation: A Comparative Study', *University of Oxford Legal Research paper Series*, Paper No 55/2009, p. 8.
[65] See Question 28 of the Survey, available at http://denning.law.ox.ac.uk/iecl/ocjsurvey.shtml [last visited August 31, 2010].
[66] See Question 41 of the Survey.
[67] See Question 42 of the Survey.
[68] See Question 43 and 46 of the Survey.
[69] See Question 45 of the Survey.

Does this mean that there is no scope for harmonization whatsoever? Not necessarily. In Section 5, the possibility of harmonized procedures as an additional option to choose from was already mentioned. This approach fits in an economic line of reasoning. Furthermore, as has become clear in the above sections, Law and Economics identifies the potential costs and benefits of harmonization. Generally speaking, the benefits seem to be restricted to possible transaction cost savings. The Oxford Civil Justice Survey suggests that differences in civil justice systems do not deter international trade, so it is questionable if the transaction cost savings outweigh the social costs of harmonization.

For specific topics this may be different. For example, in case of uncontested pecuniary claims, the fact that the underlying substantive law which determines whether there is a debt and how large it is may differ, is irrelevant. After all, the debt is uncontested. Furthermore, given that there is no substantial precedent-value of rulings in such uncontested pecuniary claim cases, it is desirable to process such cases at the lowest possible costs. Hence, uncontested pecuniary claims are an area where the costs of harmonization are relatively low while the benefits may be substantial. However, it remains far from clear if the benefits outweigh the costs of shifting to a new system and if the centralized legislator is better able than the decentralized legislators to design an optimal system of handling uncontested pecuniary claims.

The question whether the benefits of harmonization outweigh the costs is ultimately an empirical question which I cannot answer in this paper. The Oxford Civil Justice Survey suggests that differences between civil justice systems are a relevant factor for businesses, but they do not deter them from international trade, not are they generally regarded as a barrier to trade. In my opinion, the scope for harmonization of procedural law from a Law and Economics point of view hence is at best limited and it should have an optional character.