

# **DESIGNING LAW**

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# Institutional design

What do we mean by design?

- Fitting form to function
  - In architecture?
  - In clothing?
  - In writing contracts?
  - In writing constitutions?
  - In writing laws and bylaws?

## Is design suspect?

- Because designers are out of touch with the real world?
- Working from
  - First principles ?
  - Under a blue sky ?
  - On blank sheets ?

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First principle: minimally sensitive to local traditions

Blue sky: minimally sensitive to constraining circumstances.

Blank sheets: minimally sensitive to past practice.

## Making law

- Law from below: customary law
  - People's needs are the driving force
- Law from above: statutory law
  - Sovereigns' needs are the driving force
- Is there a role for science?

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### Law and economics

- facilitate collective action, or at least not exacerbate
- reduce negative externalities
- increase positive externalities

## Goals

- Say something about the problems involved in designing law
- Suggest some principles to aid in designing good law
  - Designing law is taken to be the same as designing an institution. Hence, understanding institutions becomes essential.

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Based on

Goodin, Robert E. “On Constitutional Design”, ARENA Paper 26/1997, Oslo, University of Oslo,

Goodin, Robert 1996 (ed.) “The Theory of Institutional Design”, Cambridge, Cambridge University Press,

North, Douglass C. 1990 “Institutions, Institutional Change and Economic Performance.”, Cambridge, Cambridge University Press,

Soto, Hernando de. 2000 “The Mystery of Capital. Why Capitalism Triumphs in the West and Fails Everywhere Else”, New York, Basic Books

## Design of formal institutions

Consists of

- Writing law
- Mandating a bureaucracy
- Staffing the bureaucracy

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Our primary concern will be formal institutions. That is institutions created by politics through written law and budget allocations for people to administer the law.

## Fitting form to function

- **Function:** the goals the institutions is supposed to achieve
- **Form:** the diverse combinations of legal rules, bureaucratic organisation and the goals and competences of the bureaucratic staff

FIRST IMPLICATION: we need to understand how institutions work

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## Learning about institutions from

- Classical institutional theory in sociology and economics
- Neo-institutional in economics, and in
- Political science, anthropology, sociology
- Philosophy, law, history, game theory, experimental psychology/ economics/ political science, .....

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## Institutions

- Rules of the game
- Humanly devised constraints
- Providing structure for human interactions (political, economic and social)
- The cost of detection of rule violations, and the enactment of punishments are essential parts of all institutions.

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North(1990:3). “Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.” ... “Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change.”

# Organisations

- Games: rules and players
  - Institutions – organisations
- Organisations are groups of people bound by some common purpose to achieve objectives

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If institutions are the rules of the game, organisations are the players of the game.

## Institutions evolve by incremental change in e.g.

- Values and priorities
- Norms of behaviour
- Conventions
- Codes of conduct
- Contracts
- Common law
- Statute law

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## Institutions determine the opportunities of a society.

- Organisations are created to take advantage of those opportunities.
- As organisations evolve they change the institutions. The path of change is determined by
  - A lock-in between institutions and the populations of organisations evolved to exploit the institutions
  - Feedback processes from perception of and reaction to changes in the opportunity set.

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North(1990:7) The resultant path of institutional change is shaped by (1) the lock-in that comes from the symbiotic relationship between institutions and organisations that have evolved as consequence of the incentive structure provided by those institutions. And (2) the feedback process by which human beings perceive and react to changes in the opportunity set.

The increasing returns characteristics of an institutional matrix that produces lock-in come from the dependence of the resultant organisations on that institutional framework and the consequent network externalities that arise.

## Reading de Soto 2000:

- Hernando de Soto provides empirical observations of the dysfunctional consequences of
  - Illegitimate and insecure property rights
  - Poorly enforced laws
  - Barriers to entry of markets
  - Monopolistic restrictions
- Resulting in permanent underdevelopment

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The high transaction costs are leading to firms with

- Short time horizons
- Little fixed capital
- Small scale operation

North 1990 p 67 refers to de Soto 1989 “The Other Path” on transaction costs in third world countries and how the lack of enforcement leads to a third sector outside the law with mostly self-enforcing transactions.

Eggertsson 1990 p273-275 refers to the same study in addition to Litan, Robert E. and Schuck, Peter H. 1986 “regulatory Reform in the Third World: The Case of Peru”, Yale journal of regulation 4(No.1, fall)

## 5 mysteries of capital

- Missing Information
- Capital
- Political Awareness
- Missing Lessons of US History
- Legal Failure

## Missing Lessons of US history

- Squatting was common
- Pre-emption: squatters improving land could recover its value or buy the land before it was offered in public sale
- Gradually the extralegal sector was recognized and integrated in to the formal system

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## Legal Failure (1)

- Misconceptions of current policy
  - People go to the extralegal sector to avoid paying taxes
  - Extralegal real estate exist because of inadequate surveying and mapping
  - Mandatory law is sufficient, compliance costs irrelevant
  - Existing extralegal social contracts can be ignored

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## Legal Failure (2)

- It is impossible to change people's conventions on how they can hold their assets, both legal and extralegal without high-level political leadership

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deSoto(2000:157): “The crucial thing to understand is that property is not a physical thing that can be photographed or mapped. Property is not a primary quality *of* assets but the legal expression of an economically meaningful consensus *about* assets. Law is the instrument that fixes and realizes capital. In the West, the law is less concerned with representing physical reality of buildings or real estate than with providing a process or rules that will allow society to extract potential surplus value from those assets. Property is not the assets themselves but a consensus between people as to how those assets should be held, used, and exchanged.”

## Legitimation

- Law must build on existing social contracts
- The extralegal sector has developed their own law, their own understanding of what property is and what they can do with it
- Unless land reform builds on this, it will fail miserably as the many failed attempts at land reform already should show us

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## Making better formal law

- Study the various extralegal sectors
- Extract the principles used by the people
- Compare it to existing law
- Adjust formal law and insert the principles used by people
- The result is much nearer a self-enforcing system of law

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deSoto(2000:187): “Where have all the lawyers been? Why haven’t they taken a hard look at the law and order that their own people produce? The truth is that lawyers in these countries are generally too busy studying Western law and adapting. They have been taught that local practices are not genuine law but a romantic area of study best left to folklorists. But if lawyers want to play a role in creating good laws, they must step out of their law libraries into the extralegal sector, which is the only source of the information they need to build a truly legitimate formal legal system.”

## The political challenge

- Changing status quo of property rights is a major political task requiring
  - Taking the perspective of the poor
  - Co-opt the elite
  - Deal with the legal and technical bureaucrats guarding the current system

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deSoto(2000:204): “People do not want to get inside the formal property system because they are eager to be mapped, recorded, or taxed; they will join the system when its economic benefits are obvious to them and when they are certain their rights will continue to be protected.”

## Traditional law: AD 1274

- "Bears and wolves can be hunted by anyone in any person's outfields except where bears are circled in their land; this he shall promulgate publicly that it is his circle. Now, others hunt the bear, then they hunt for that one, who owns the circle and "landnaam" to the landlord"

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Magnus Lagabøter's Landslov 1274 Section VII, chapter 58 in Taranger 1915 (page 153-154)

"Bjørn og ulv skal i hver mands utmark være veidende for hvem som vil, undtagen der hvor bjørn er ringet i hi; det skal han lyse i folkeforsamling, at det er hans ring. Nu veider andre bjørnen, da veider de for den, som eie ringen og landnam til jorddrotten."

Frostatingslova Section VIII paragraph 6 and 7 in Hagland og Sandnes 1994 (page 191)

"Den skal ha bjørn som veidde han, med mindre han vert stengd inn med trevyrke; då skal den ha han som stengde." og

"Ingen skal gildra i annan manns mark etter noko dyr, anna enn etter varg og rev og oter, og ingen skal grava dyrgrav på annan manns grunn, med mindre den gjev løyve som eig grunnen, og ikkje bryt opp stein."

## Contemporary law: AD 1981

- ”All wildlife, including its eggs, nests, and lairs are inviolable except if otherwise follows from law or decisions based on law. ... ”
- ”The King decides which species can be hunted and within which time frames the hunting can take place. The Directorate decides the time frames of each species and within which areas hunting can take place. ... ”

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Act of 29 May 1981 no 38 on wildlife

§3 Alt vilt, herunder dets egg, reir og bo er fredet med mindre annet følger av lov eller vedtak med hjemmel i lov. ...

§9 Kongen fastsetter hvilke arter som kan være gjenstand for jakt og innenfor hvilke tidsrammer jakten kan foregå. Direktoratet fastsetter jakttiden for den enkelte art og innen hvilke områder jakten kan foregå. ...

### **Forskrift om forvaltning av bjørn, jerv, ulv og gaupe**

§ 1 Formålet med denne forskrift er å sikre overlevelsen av bestander av bjørn, jerv, ulv og gaupe på lang sikt. Innenfor denne ramme skal det arbeides for at de skader disse rovviltartene volder for bufe- og tamreinnæring blir minst mulig.

Forvaltningen skal være differensiert slik at hensynet til vern av rovviltbestandene og hensynet til beitebruk vektlegges forskjellig i ulike områder og for de ulike rovviltarter.

# Design principles

## Traditional

- Specific guidance to action

## Contemporary

- General rules and delegation of decision making power

## Assumptions for design

1. Behaviour of agents are sensitive to available opportunities and incentives
2. Opportunities and incentives varies and can be varied by design to affect aggregate behaviour
3. There are some accepted criteria for what one wants to achieve by the design intervention

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## Some desirable principles (1)

- Revisability
  - People are fallible
  - Societies change
  - Learning by doing
- Robustness
  - Making commitments and stand by them
  - Avoid opportunistic changes of institutions
  - Adapt to new situations by appropriate changes
- Sensitivity to motivational complexity

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Sensitivity:

- Checks and balances of power
- Bill of rights for individuals
- Pluralist governance institutions
- Participatory procedures

## Some desirable principles (2)

- **Publicity**
  - All institutions and institutional action must be in principle publicly defensible.
- **Variability**
  - Learning by doing requires and produces variability of institutions
  - Federal institutions may provide variability
  - Learning from neighbours may lead to a “race to the bottom”, where worst practice is imitated rather than best practice

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Should we design institutions for knaves, or should we bet on people having higher motives, or at least that enough people have higher motives?

Designing institutions with publicity in mind may avoid selfishness as a guiding motive, but will it avoid sacrificing a large fraction of the community to some “higher” moral purpose?

Can we make assumptions about the frequency of various personality types (knaves to angels) in a population in our design work?

JUDGING THESE PRICIPLES: DO THEY SAY ANYTHING ABOUT

- OPTIMALITY?
- EFFICIENCY?
- ADAPTIVITY?
- LEARNING?

## Two basic ways of intervening

- Designing sanctions to alter opportunities and incentives
  - Sanctions are positive as well as negative
- Designing filters to create or eliminate agents or opportunities
  - Removing or awarding powers to agents
  - Creating or removing opportunities

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Two types of goals for design

- Prevent harm –vs.– promote good
- Controlling powerful, dangerous agents (private agents) –vs.– controlling agents in which we have put our trust (public agents: police, military, judiciary, politicians)

## Design strategy 1: deviance control

- Deviance-centred strategies aim at making compliance the self-interested alternative for everyone, also the pure egoists (aka “the knaves strategy”)

Problems:

- “Quis custodiet custodes”
- May create knaves of non-knaves

Perhaps it may do more harm than good?

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Creating knaves of non-knaves (Switching from non-egocentric thinking to egocentric) by

1. Switching on the red light (alerting to the possibility of significant egocentric motives)
2. Driving out or marginalizing non-egocentric thought
3. Signalling demoralizing attitudes on the part of authorities
4. Signalling new options and opportunities
5. Signalling that others probably have been knaves, taking you for a ride
6. Adverse selection to roles where self-seeking behaviour is unwanted

## Design strategy 2: complier reinforcement

- The complier-centred strategy aim at reinforcement of the behaviour of the non-egocentric thinking persons
  - Screening before sanctioning
  - Sanctioning in support of non-egocentric deliberation
  - Sanctions should be motivationally effective

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