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Conceptual divergence: an inter-disciplinary perspective using economics

Contribution for Binding Unity / Diverging Concepts

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The aim of this contribution is to shed a different light on the discussions taking place within the Binding Unity / Diverging Concepts project, with the help of the literature on the economic analysis of the law. At this point in time, this piece is still very tentative.

At the outset, it is perhaps appropriate to set out briefly three propositions which are central to this contribution. They represent the main "lessons" to be drawn using economic analysis of the law (and the attendant literature) for the purposes of this project:

1. It is crucial that the law be seen in a broader context, i.e. including both the policy choices underlying it and its practical outcome. This is basic point arising out of any inter-disciplinary research involving law ("Law+");
2. Economics tells us that almost every change involves a tradeoff. In the words of Friedman, "there is no such thing as a free lunch". Jurists are notoriously weak here. We tend to focus on the downsides (disadvantages, costs) of the current situation and the upsides (advantages, benefits) of the envisaged change when deciding whether to change (grey in table below), often ignoring the upsides of the current situation and the downsides of the envisaged change.

Complete decision matrix	Costs	Benefits
Current		
Change		

3. Without wanting to turn this into a normative statement, the economic analysis of law (like economic science in general) tends to emphasize that the "spontaneous"[1] ordering of law (and of society) must at least be carefully studied on its merits, and that it will often turn out to be adequate (i.e. in equilibrium).

For the purposes of this contribution, the working definition of conceptual divergence put forward by Bert van Roermund will be used:

> A legal term T is conceptually divergent between agents A and B, if T is common parlance between A and B, and if the sense and/or the reference of T yields meaning M_1 for A and M_2 for B, such that A and B can use M_1 and M_2

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[1] Of course, there is no such point of reference as a "spontaneous" market economy at the scale and level of our large industrialized societies, as economists would sometimes claim. Economics tend to take for granted a set of basic law which enables the market economy to work in the first place (usually the basic legal disciplines as they would be reflected in codes or the common law). "Spontaneous" should perhaps be better read as "bottom-up" in the context of this project.

> to argue differing courses of action as lawful (or unlawful) under the legal order they are both committed to.

It is worth noting that the bulk of the literature concerning divergence between legal systems has so far been concerned with another type of divergence, which I would call "explicit divergence": this arises where there is a conscious choice to use different terms and different concepts to deal with a similar problem.[2] In a case of explicit divergence, there is no doubt in the minds of the agents that there is divergence, whereas in the case of conceptual divergence, it can be that the agents believe that there are indeed using the same concept, since they label it with the same term, while they are in fact using diverging concepts. I will come back to this point during this paper: sometimes the standard analysis must be adapted to deal with conceptual divergence, but very often it makes no difference whether the divergence is explicit or conceptual.

First, this contribution examines why different legal systems would diverge (I). Then, it deals with methodology, i.e. what is divergence and how it can be detected (II). Thirdly, it explains under which conditions divergence should be seen as a problem (III). Finally, it explores possible solutions to the problem (IV) before concluding (V).

I. Why would divergence occur?

When browsing through the legal literature, one cannot escape the impression that jurists are slightly (at least) biased against divergence. Convergence, harmonization and even stronger phenomena like unification are often perceived as positive developments in and of themselves. Even those who write in praise of divergence present it in such a fashion (calling upon irreductible cultural differences beyond apprehension) that it seems to border on the irrational, a line of argument which ultimately feeds into the bias against divergence.

Still, why would divergence occur at all? With the use of economic theory, divergence can be rationally explained with at least three lines of reasoning.

A. *Divergence as a rational but not deliberate phenomenon*

Under this line of reasoning, divergence can be explained rationally, but it does not necessarily result from a deliberate choice on the part of those concerned. Two different strands of economic theory can be brought to bear here.

Firstly, divergence can be explained by *informational imperfections* (or asymmetries) as between various jurisdictions. The law progresses in great part as a result of outside pressure, which takes the form of new information about the world outside the law (e.g. a new case never seen before, technological developments, social evolution, etc.) that the law must then process. Legal systems evolve within different informational environments.The comparative scholar will often observe that certain areas of the law are more developed in certain jurisdictions as a result of specific historical

[2] Within different legal orders or within a single order which allows this practice under certain circumstances, like a federation.

occurences.[3] Similarly, larger jurisdictions tend to run ahead of cutting-edge legal developments because statistically novel cases will tend to arise there first. Divergences can thus result from informational imperfections.

Secondly, recent developments in network economics can also help to explain divergence. The starting point is the notion of *network effects* (also presented as demand-side scale effects): for certain products, the value of the product to the individual user increases as the number of users increases. The classical example is telecommunications: in the absence of interconnection, the value of a subscription to a network with 1000 subscribers is much less than that of a subscription to an otherwise identical service provided over a network with 1 million subscribers. In telecommunications, network effects are strong, but the theory can also be applied more loosely to other phenomena, including fashion and language. It can be ventured that the "market" for legal ideas is also subject to network effects: the more members of the legal epistemic community subscribe to a given opinion, the more attractive it becomes, sometimes irrespective of its inherent validity.[4] The effect is not as strong as in telecommunications, of course, since a number of jurists – fortunately so in many circumstances – can still decide not to be swayed by the mere fact that the majority holds a certain view, and hope for a reversal.

If it is accepted that network effects are present in legal ideas, then two specific properties associated with these effects can explain divergence. The first one is called *tipping*: a small movement in demand can trigger a snowball effect.[5] In the case of legal ideas, a single decision or a leading article at a given point in time can quickly lead to the emergence of a majority view. The second one is called *path dependency*: once network effects have worked to the advantage of one firm, it becomes very difficult to "change the course of history".[6] In the case of legal ideas, here as well once certain choices have been made and are deeply imbedded in the shared knowledge of the legal community, they are difficult to reverse. Accordingly, legal systems can evidence divergences as a result of discrete choices made differently in the past, whose consequences are then amplified by network effects (including tipping and path dependency). Indeed on many issues (for instance, the relationship between contract and tort law), if one goes sufficiently far back in time, the same or very similar debates can be found in each system. Sometimes it sufficed that a single leading author or court chose option A in one system and B in the other for these two systems to evidence "irreconcilable divergences" later on, after network effects have done their work.

B. *Divergence as a rational, deliberate and benign phenomenon*

The explanations above assume that divergence does not result from deliberate action. The more classical and traditional explanation for divergence, however, involves

[3] For instance the doctrine of *Wegfall der Geschäftsgrundlage* in Germany as a result of the Great Depression.
[4] Hence the practice of pointing to the majority and minority views when there is a controversy.
[5] This lies at the heart of the commercial strategy of most firms active in sectors affected by network effects.
[6] This is equally important in the commercial strategy of larger firms active in sectors affected by network effects, for instance Microsoft.

deliberate choices made by the members of a community as regards their legal system, in other words *local preferences*.

In essence, the legal system reflects the consensus of the community (or at least of the ruling class) on the balance to be reached between competing policy interests. Some trade-offs are involved, and they are not always resolved in the same manner from one community to the other. For instance, in a given community, more emphasis will be put on ensuring that injured persons receive compensation, while in another one, the need not to overburden economic actors with liability claims will prevail. The laws of these respective communities will then most likely diverge.

C. *Divergence as a rational, deliberate but less benign phenomenon*

A third line of argument builds on the previous one, but adds a twist. Whereas the previous account assumes deliberate decisions taken in good faith and with a view to the public interest, *public choice* theory would consider the production of law as a market responding to general economic principles, for instance demand and supply models, pricing theory, etc. Accordingly, the production of law will favour the interests who are best able to articulate their demand and offer a valuable counterpart to the producer of law. Public choice theory can be used to explain lawmaking in complex settings involving interest groups, lobbying and other features of modern-day democracies.

Public choice theory can account for divergence as a rational and deliberate phenomenon. However, the outcome in each jurisdiction might be affected by market imperfections, including the presence of market power on the part of certain interest groups vying for the production of law, information asymmetries. The outcome is thus not necessarily in line with the general public interest in that jurisdiction. It could be ventured that the presence in certain jurisdictions of very developed systems of admissibility control in public law claims, for instance, reflects success by the administration in influencing the production of law (here administrative procedure) rather than the greater general good.

D. *Concluding note*

Three different lines of argument were explored, all of which would explain why the law could be different from one place to the other, and would do so in a more convincing fashion than endless invocations of irreductible differences between legal cultures.

It will be noted that these lines of argument do not require a specific level of comparison. They can explain differences between legal systems, of course, but they could also explain differences within a single legal system. Their point of reference is not a geographical territory or a hierarchical entity (legal system), but rather a legal epistemic community.

More importantly, these three lines of argument can explain conceptual divergence equally well as explicit divergence. It makes no difference whether a common term is used or not.

II. When is there divergence?

In the light of the foregoing, there appears to be ample reason for divergence (explicit or conceptual) to appear. A foray into methodology is then necessary, to ensure that divergence will only be found where it really exists.[7]

Indeed there could be a methodological trap in the project, having to do with the focus on keywords (including short key phrases of a few words). Jurists like to work with keywords, since it simplifies their task considerably by enabling them to put a shorthand label on concepts. At the same time, these keywords have the unfortunate tendency to take a life of their own, i.e. they are used sometimes without careful consideration of all the conceptual baggage that accompanies them.

If the background of keywords gets lost, and given the inherent indeterminacy of language, there is a fair chance that misunderstandings can occur (two persons use the same keyword but realize that they do not give it the same meaning). For the purposes of this project, this could lead to conceptual divergence.

Yet, contacts with economists have shown that other approaches are possible. When two economists suspect that a difference in opinion might stem from a discrepancy in the use of keywords, they often go back to the underlying concepts, rolling out at full length their respective definitions of these keywords and referring to literature in so doing. On an absolutist view of linguistic indeterminacy, this could be a step in the wrong direction: even more indeterminate terms come into discussion. On the other hand, practical experience seems to show that expanding the discussion from one keyword to one paragraph increases the chances of agreeing at the conceptual level, or at least of narrowing the difference in opinion down to a sub-part of the concept behind the keyword as opposed to the whole keyword. Discussion can then move forward.

Legal research is also aware of that trap and tries to look beyond keywords. Its methods still suffer from flaws, however. For instance, classical comparative law tends to take a point from within the law (often expressed as a keyword) as a basis for comparison. Each legal system will be entered into from that point. Typically, that point and its immediate surroundings will then be brought into a relatively descriptive inquiry and quite typically as well, a finding of discrepancy will be returned. The conclusion will tend to be that the legal concepts and the legal reasoning differ. Very often, the civil law/common law divide will bear the blame for this (when the sample of legal systems under study allows for it).

In some respects, the Binding Unity / Diverging Concepts project wanders down that path, with its focus on “rights” and “discretion” and its examination of how these keywords are conceptualized in various legal systems and parts of the law.

Yet ascertaining differences in legal concepts and reasoning should not be enough to warrant a finding of divergence. A broader methodological perspective is needed. It involves looking beyond the “middle layer” of legal concepts and reasoning to

[7] This part of the paper is based more on research experience in comparative law and inter-disciplinary work with economists than on standard law and economics literature.

incorporate also the "upper layer" of policy considerations and the "bottom layer" of practical outcomes. Instead of beginning the inquiry via a legal concept, the starting point is rather found outside the law, by way of a practical problem. The aim of the inquiry is then to ascertain whether legal systems, seen broadly with their respective three layers, produce the same or a similar outcome on the basis of roughly the same policy considerations. Whether the legal concepts and reasoning used in doing so are similar should not be of prime relevance. Only when the outcomes differ (usually because the policy issues have been settled differently) is there a sufficient basis for a finding of divergence.

For instance,[8] the laws of France, Germany and England do diverge on the treatment of pure economic loss under the law of liability. However, within that sample, the laws of Germany and England tend to converge both at the policy and at the outcome level,[9] even if they evidence differences in legal concepts and reasoning. French law differs fundamentally from both, however, in policy and outcomes. The divergence is thus mainly between German and English law, on the one hand, and French law, on the other. In all of this, the civil law / common law divide is of secondary significance as an explanatory factor.

The definition of conceptual divergence put forward by Bert van Roermund is amenable to this methodological approach.

III. **What is wrong with divergence?**

Once there is a finding of divergence, the discussion is naturally drawn to the more normative question of whether it is undesirable.

In the first part of this paper, three lines of argument were set out to explain why divergence can occur. It can be noted that of the three, only the "local preference" argument – the second one – provides a stable (and strong) explanation for divergence. Still, local preferences can evolve. The first line of argument (rational but not deliberate) implies that divergence can disappear over time, if information imperfections are removed. Network effects can work in favour of one or another outcome and would not prevent divergence from disappearing. The third line of argument (rational, deliberate but not benign) implies that divergence results in part from different power configurations which are not necessarily stable.

Even then, the mere fact that divergence is not stable over time does not mean that it is undesirable.

A. *Convergence as a value in and of itself*

Here, we jurists sometimes fall into the classical trap of thinking that convergence (and ultimately unity) in the law is a value in and of itself.

[8] For more on this and on the functional approach in general, see the work of the Ius Commune Casebook Project, in particular the *Casebook on Tort Law*.

[9] Save for the fact that Germany tends to make greater use of contract law devices to soften the impact of the disallowance of recovery for pure economic loss.

First of all, convergence has enormous intellectual appeal, but that of course is not a sufficient justification.

Secondly, jurists sometimes put forward rights-based arguments for convergence: it would be everyone's right to have similar situations be treated in the same way across legal systems or communities. Given the arguments made above to explain why there might be divergence, I do not think that a mere assertion of rights is sufficient to trump the cards.

A third but related argument is very present in EC law, namely the need to ensure the effectiveness of the law (here, EC law). This argument pertains more to conceptual divergence within a larger system such as EC law: it would be essential to ensure that EC law is interpreted, applied and enforced the same way throughout the EU, lest it lose its effectiveness. After all, the ECJ has construed the EC Treaty in a very purposive fashion, which naturally leads to emphasizing effectiveness. At the same time, throughout its case-law, the ECJ is also willing to accept a degree of divergence in the laws of the Member States.

Indeed the ECJ judgment in the *Tobacco Advertising* case[10] provides a useful reminder that convergence is not a value in and of itself. Writing about the availability of Article 95 EC as a legal basis, the Court stated that:[11]

> [i]f a mere finding of disparities between national rules and of the abstract risk of obstacles to the exercise of fundamental freedoms or of distortions of competition liable to result therefrom were sufficient to justify the choice of Article [95] as a legal basis, judicial review of compliance with the the proper legal basis might be rendered nugatory.

In *Tobacco Advertising*, the ECJ laid down the bases for a more economic approach to the use of Article 95 EC as a legal basis. Indeed from an economic perspective, the mere fact of divergence is not undesirable. In order to come to a normative conclusion, the assessment must look more broadly at the costs and benefits of divergence (and in a later step, discussed below, at the costs and benefits of removing divergence).

B. *The costs associated with divergence*

The benefits of divergence flow from the lines of argumentation put forward earlier. Essentially, each legal system is then better attuned to its respective reality.

In principle, divergence as such does not create costs. Costs generally arise when diverging systems are actually communicating with each other. Communication can take place though various means, be it trade in goods, movement of persons, etc. In other words, if two systems showed divergence – conceptual or explicit – but were not otherwise in contact with each other, there would be no reason to intervene, from an economic perspective.

[10] ECJ, 5 October 2000, Case C-376/98, *Germany* v. *Parliament* [2000] ECR I-{…}.
[11] At Rec. 84.

More specifically, when diverging systems communicate, the following costs might arise:

1. *Externalities*: Normally, the state of the law should reflect the choices made in a given jurisdiction, in the light of the various tradeoffs involved. It is possible, however, that the choices made in a jurisdiction impose costs which are borne by another jurisdiction, in which case the choice of the first jurisdiction is not based on a complete picture of costs and benefits (tradeoffs) involved. A typical example is environmental legislation in the presence of cross-border effects (water and air flows across boundaries). In the presence of externalities, there is no reason to respect divergence arising from local preferences (e.g. minimal pollution controls upstream), since they can result in sub-optimal results overall (e.g. unwanted pollution downstream).

2. *Transaction costs*: When there is trade between jurisdictions, divergence creates transaction costs. Indeed participants in trade – sellers as well as buyers – must acquire knowledge about the legal situation in other jurisdictions in order to engage into trade efficiently (otherwise, they incur risks). On the seller side, this means that products, terms and conditions, etc., must be adapted to meet the legal requirements of a number of jurisdictions, thereby increasing the cost of production. On the buyer side, the cost of buying can also be increased, but more likely (especially with consumers), buyers would refrain from buying outside of their jurisdiction. The same applies to business transactions other than sale and even to personal endeavours (employment, family matters). Transaction costs offer a very powerful argument against divergence. With respect to consumers and persons in general, transaction cost analysis can reinforce rights-based arguments: the right of a person to be treated the same way irrespective of the legal system in question can be justified because it is deemed unacceptable that persons should bear the transaction costs associated with divergent legal systems.

Externalities and transaction costs are the standard arguments used to support the conclusion that a given instance of divergence is undesirable. These arguments apply equally to conceptual or explicit divergence. Presumably, transaction costs are higher in the case of conceptual divergence, since the precise scope of the divergence is harder to ascertain.

In addition, a third type of cost could be associated with conceptual divergence only, namely costs arising from *information imperfections*. Indeed conceptual divergence differs from explicit divergence in that, on the surface, the same term is used, but with diverging concepts. Ideally, individuals and firms should spend enough resources to ascertain the legal situation that they would come across conceptual divergences as well, and the problem would remain one of transaction costs. There is however a risk that they would not look beyond the surface – perhaps with a view to keep transaction costs under control. They would then take decisions based on the assumption that the same term is conceptualized in the same way in every jurisdiction, only later to find out that their assumption was wrong (at their cost, but perhaps also to their benefit). They could thus be misled into taking decisions which they would not have taken with complete information on the status of the law. This can lead to inefficiencies, in the form of unsuspected losses or extra costs to undo mistakes.

In the end, divergence is not undesirable as such. Yet in many cases it engenders significant costs, such as externalities, transaction costs and (in the case of conceptual divergence) costs arising from information imperfections. These costs can exceed the benefits from divergence and thus justify the conclusion that divergence should be addressed. However, the inquiry does not end here. It must still be ascertained whether change would lead to an improvement.

IV. **What can be done about divergence?**

A number of options are available to deal with a situation in which divergence would be undesirable.

A. *Do nothing and leave the market to deal with it*

At the outset, it must be remembered that markets typically provide solutions to deal with certain costs associated with diverging legal systems.

First of all, if parties can influence the law through contract, they will likely do so. In commercial contracts, for one, parties can either opt for one or the other legal system (or a third one) or define the law *inter partes* themselves.

Secondly, in commercial but also in consumer relationships, the insurance market can offer a possibility to translate divergence into quantitative terms, i.e. an insurance premium. In the case of liability laws, in particular, insurers have superior knowledge of the state of the law in each market and can provide a lower-cost alternative to endless inquiries, product modifications, etc. If a firm wants to keep relatively uniform prices, it can then equalize the cost of insurance over all of its customers.

These solutions can only work in certain cases: for instance, divergences in administrative procedure cannot be compensated via contract or insurance. In situations where they are available, however, these market-based solutions can be attractive, especially if there are no externalities involved and the costs associated with divergence (transaction costs, information imperfections as the case may be) are limited in comparison with the value of the overall activity. Market-based solutions apply equally to explicit and conceptual divergence.

B. *Top-down harmonization*

Jurists tend to be less sanguine than economists about divergence between legal systems, and they readily see it as a problem. What is more, they often propose to remedy that problem with a fairly drastic solution, namely harmonization or even unification of the law. In such a process, the respective laws of each legal system, on the area when divergence is deemed problematic, are replaced by a single law common to all systems.

The benefits of harmonization are that the costs of divergence are removed. Of course, given the complexity of the law, harmonization exercises sometimes end up replacing explicit divergence with conceptual divergence or merely pushing conceptual divergence deeper, so that it does not deliver all the expected benefits.

As mentioned at the outset, jurists tend to ignore the benefits of the current situation and the costs associated with change. Even if divergence leads to costs, it is conceivable that harmonization would generate even higher costs.

First of all, harmonization can remove the benefits associated with divergence, first and foremost that the law is better attuned to local preferences. Presumably, if divergence were found to be a problem, it is because the costs flowing from divergence exceed those benefits, and therefore if harmonization can remove these costs, it would still produce an overall benefit even if the benefits of divergence were removed by the same token.

Secondly, however, harmonization can also generate costs of its own. In rare occurrences, the area to be harmonized is relatively autonomous within the law as a whole. More frequently, this area interacts with the rest of the law. For instance, product liability or State liability for breaches of EC law are part of the law of liability and more generally of private and/or public law. Ahead of harmonization, each legal system is in an equilibrium of sorts: the various areas of the law are seamlessly integrated into the legal system (at least this is the model). Top-down harmonization, coming from the outside, implies a break within the legal system, i.e. the creation of a specific "harmonized area" which co-exists with other remaining areas. In the ideal situation, implementing (incorporating) the harmonized law should be done seamlessly, without distorting the legal system. For instance, under EC law, the very mechanism of the directive is meant to allow Member States for some room to adapt the harmonized law to their legal system and thereby minimize distortions. The ideal being an ideal, more often than not harmonization will generate distortions within the legal system or miss its goal because harmonization is undone at the implementation stage (as mentioned above), or even both.

When faced with such distortions as a result of harmonization, legal systems can react in two ways. Firstly, via a kind of ripple effect, the changes introduced in the harmonized area can induce further changes outside of the harmonized area in order to restore the system to a seamless equilibrium. There are numerous examples of Member States using the implementation of a directive as an opportunity to change a broader area of their law (often in a spirit of "cleaning up"). Such a ripple effect generates costs, but they are limited in time. Secondly, the legal system can treat the harmonized area as a form of foreign body (*Fremdkörper*) and seek to isolate it. For an example, see the reaction of German courts and writers to the introduction of State liability for breaches of EC law via the *Francovich* and *Brasserie du Pêcheur* judgments. The ensueing tension within the legal system generates costs on a lasting basis.

Accordingly, top-down harmonization efforts must be analyzed as a trade-off between the benefits of harmonization (removing the costs associated with divergences, but with a measure of uncertainty as to the result) and the costs associated with inducing distortions within legal systems.

The above analysis applies to explicit as well as conceptual divergences. In the latter case, however, the divergence often sits very deep in the legal system. There is an illusion of convergence in terminology and presumably a fair amount of conceptual

overlap, but somewhere at the conceptual level undesirable divergence was found. The benefits of harmonization must be discounted with a higher degree of uncertainty as to the results, therefore, given the more extensive "reschooling" and "retooling" needed. By the same token, it is more likely that harmonization will induce significant distortions and thus costs.

C. *Bottom-up alternatives: regulatory competition*

Between doing nothing and introducing top-down harmonization, there is a third option, namely relying on bottom-up processes to bring about convergence when needed. This is essentially a more sophisticated version of the doing nothing alternative, or to use an oxymoron, doing nothing with a plan.

If legal systems diverge but they do communicate with each other through trade and other forms of exchange, they will also communicate at the intellectual level, in the proverbial marketplace of ideas. If the various legal epistemic communities are introduced to each other's ideas, one could expect that they will compare them. Over time, they might adopt the policies, concepts, reasoning or outcomes of another community if they are convinced that it is preferrable. A certain amount of convergence will then result.

Of course, if divergence echoes local preferences, one could object that local law will remain in place even after the comparison. However, in many cases, the need to reduce transaction costs and improve trade will act as a counterweight and will provide an incentive to move away from a law based strictly on local preferences. This is the theory of *regulatory competition*, explained in the companion paper of Arnald Kanning.

For bottom-up solutions such as regulatory competition to function, however, circulation of ideas between legal communities is a condition *sine qua non*. At this juncture, in Europe, such exchanges are still in their infancy. While EC law fosters the free movement of ideas (among others), there are still vast areas of law (and of the legal community) which remain generally shielded from any confrontation with ideas from other legal communities. National legislation and judgments of national courts are not disseminated beyond national borders, and only a small group of academics actually looks across these borders.

V. **Conclusion**

This contribution attempted to bring a different perspective to bear on the Binding Unity / Diverging Concepts project. In general, the use of economic analysis tends to reduce the sense of urgency which might be felt when conceptual divergences are detected. Indeed, by and large, the various economic analysis tools used to examine explicit divergences are applicable to conceptual divergences as well. As is the case with explicit divergence, they show that divergence can rationally be explained, that it does not really occur that often, that it may not always undesirable and that removing it can sometimes make the situation worse.