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Legal System as a Determinant of Economic Performance: Factual Records in Romania

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Abstract: The role of the legal system in generating economic performance is enjoying increased attention in literature. Our scientific endeavour tries to underline, from an original perspective, the incoherence which characterises the Romanian law and judicial system; at the same time, it also offers a few solutions meant to restore and reconsider the role of public institutions in the legislative and judicial process. Considering the facts presented in our study, the existence of efficient legal institutions, who enforce contracts *ex post* while using the judicial infrastructure (courts and judicial procedures), is more than critical for the formation of an agreement of will between contracting parties, thus generating economic performance for private organisations by reducing transaction costs and by limiting the opportunism of economic agents. Equity, predictability, transparency and reduced costs are advantages deriving from the legal enforcement of contracts, which stimulate competition and trade, while reducing the risks associated with different types of transactions. Thus, it is necessary to implement an anti-corruption policy, to enhance the predictability of the law-making process, to reconsider and restore the attributions of institutions involved in the Romanian legislative and judiciary process, in order to promote proper civil and commercial judicial procedures, together with the analysis of the possibility to acknowledge jurisprudence as a source of law.

Keywords: law and judicial system; economic performance; institutions; transaction costs; contract enforcement

1. Introduction

The theoretical contributions and factual evidence found in literature tend to emphasize the important role that state institutions have in ensuring economic growth and development, thus creating the premises for the consolidation of an economic research nucleus regarding institutional implications. Within this context, the analysis of the way in which the law system influences economic performance becomes an extremely important topic in literature, raising a vivid general debate. Our scientific endeavour subscribes to these efforts and tries to underline, from an original perspective, the incoherence which characterises the Romanian law and judicial system; at the same time, it also offers a few solutions meant to restore and reconsider the role of public institutions in the legislative and judicial process.

Our scientific study commences with a theoretical and empirical approach of the observed phenomenon, and subsequently continues with a brief digression on the general theory of law, in order to show the optimal way in which the Romanian law and judicial system should function and to contrast it with the current state of affairs, while emphasizing the way in which economic performance is affected by the present situation.

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The paper ends with some conclusions and recommendations regarding the increase of efficiency of legal institutions and with some outlines regarding further research.

2. Theoretical and Empirical Perspectives

In what concerns the existent causal relationship between economic performance and the legal system (including the institutional network which ensures its existence – the judicial system) *via* contract enforcement, scientific literature, together with other numerous empirical studies, we can observe an ongoing exchange of views.

The existent concerns in the identification of the way in which the legal system functions and influences economic development are not necessarily new. In his fundamental work, *Leviathan*, written in 1651, philosopher Thomas Hobbes, as a founder of social contract theory, manifests the belief that entrepreneurs will never get involved in trade activities, if they have lost their trust in the coercive power of the state, meant to ensure contract enforcement.

Later, Adam Smith, in his well-known paper *The Wealth of Nations*, argues that the efficiency of the judicial system plays a significant role in determining the development level of a state.

Max Weber, this time from a historical and sociological perspective, believes that economic development derives from a rational and solid legal system. Thereby one of the main exponents of neoinstitutionalism, Williamson associates the level of transaction costs, negotiation costs and contract enforcement with economic development (Williamson, 1985).

Some authors consider that people use the law and judicial system to structure their own economic activities and to solve their disputes. As a consequence, the first step is to know the laws in general and the way they constrain economic transactions, followed by the identification of those mechanisms which sanction the contracting parties who do not fulfil their assumed obligations due to contract enforcement, mechanisms linked to the operation of courts and other legal state institutions (Cooter, 1996).

Other authors consider that the law and judicial system holds the responsibility to ensure property rights protection and to facilitate their transaction between private businesses, to define rules regarding entering and leaving a market, to promote competition and to shape economic behaviour in monopolised sectors (Gray & Associates, 1993).

As we will further show in our study, it is not enough to have laws which support the socio-economic reality, it is also important for them to be efficiently applied within the existent institutional environment, as courts have an important role in providing law enforcement (and, thus, in providing an impartial enforcement of contracts) and dispute resolutions.

Moreover, we believe that the law and judicial system aggregately influences economic performance, because the ability of courts to provide rapid, impartial and predictable resolutions depends on how well written are the laws, within a given economic reality (Sherwood, Shepherd & De Souza, 1994). For example, if a law system is incoherent and flawed, courts cannot reach a resolution in commercial disputes, for two reasons, at least.

Firstly, courts cannot decide if a certain breach of contract really occurred. This happens because in the absence of standard legal regulations, courts cannot impartially decide if a contracting partner breached the contract by misappropriating the other partner's money in a joint-venture.

Secondly, the law does not provide a suitable body of regulations which courts must follow in the case a commercial agreement was actually breached. This is the case of Russian legislation, which does not specify which contract party can be held accountable in the situation in which a property buyer discovers that his property had been illegally purchased by its previous owner (Hay, Shleifer & Vishny, 1996).

Empirical studies suggest that the law and judicial system is able to stimulate economic performance through coherent policy-making and by protecting property rights in general, and intellectual rights in particular, thus ensuring the premises for the promotion and dissemination of technical progress. The protection of intellectual property rights also determines specific related transactions and amplifies national and foreign investments in the research and development sector (Gould & Gruben, 1996).

3. A Brief Incursion into the General Theory of Romanian Law

The doctrine shows us that, being determined by purposes which impose actions, the law, a normative phenomenon, represents an attempt to discipline and coordinate social relationships, in the view of promoting generally accepted social values – property rights, lawful defence and protection of individual freedom, civil society. Consequently, the juridical norm, which is the base-cell of law, refers to a subject's rights and obligations. *Legis virtus haec est : imperare, vetare, permitere, punire – This is the strength of the law: to command, forbid, allow and punish.* The subject of law can be a person, either physical or juridical, both of private and public law (Popa, 2008).

The most important formal sources of law are the normative juridical laws which form *ius scriptum* or the *written law*, which is a complex system created by public authorities with certain normative competencies (the Parliament, the Government, other bodies of the local administration).

We have to underline that laws occupy the central place in the normative system, being issued by the Parliament, as a legislature, and elaborated according to special procedures; social relationships are only governed by these laws, and other rules and regulations are created only to develop and amend them.

However, through legislative delegation, the Government can primarily amend social relationships through ordinances, in the name of certain prerogatives stated in the Constitution. At the same time, the Constitution allows the Government to issue emergency ordinances, but only in extraordinary circumstances which require rapid amendment, and with the obligation of stating the reasons for the urgent amendment within the text of the ordinance.

The legislative activity has to rely on careful planning and on a great sense of responsibility, which means that the elaboration of legal norms requires a substantial scientific foundation capable of eliminating potential contradictions and inconsistencies. Thus, the legislative work has to be the result of a profound and precise knowledge of social and national needs, capable of foreseeing potential social consequences.

Although law enforcement is significantly important, due to its punitive character, we believe that imposing a law by taking advantage of the coercive force of a state, without taking into consideration the needs of a society, does not ensure its efficiency and durability, leading towards a general revolt against legislature; in other words, the efficiency of a legislative act depends on the legislator's capacity to inform the society on its normative activity through several media and to build its regulations in accordance with real social needs (Naschitz, 1969).

We are also mentioning that in the context of Romania's accession to the European Union, our country has adopted the Community *acquis*, embarking on a mission to rise to the Union's juridical standards.

As a result of the direct influence of the Community law over national law, for every project of law elaborated by Romanian legislature, a written motivation is necessary in order to express the compatibility of the project with the Community's policy, its reasons for implementation and future harmonisation actions deriving from it.

From this perspective, currently, Romania is undergoing a process of transition and adaptation of its national law and juridical system to the Community's system, which tends, more and more, towards the unification and homogenisation of the law systems of member states; this transition, as we will show in our study, does not lack disruptions.

We included this brief excursus in order to highlight that the law and judicial system has to enforce a clear, unequivocal normative framework, capable of providing coherent and consequent regulations, meant to honour a set of unanimously accepted social values and to guarantee free access to a politically independent judicial system. Such a system is also able to directly influence economic performance in a positive way, by reducing transaction costs for either public or private economic entities and by ensuring *ex ante* and *ex post* contract enforcement.

4. Incoherence of the Romanian Law and Judicial System

A thorough analysis of the Romanian legislative system, even without being exhaustive, leads to the observation of certain – let us name them – incoherence, regarding the adoption and implementation of laws, as well as the judicial network in itself.

Firstly, our attention is drawn to the large number of normative acts that have been issued during the past few years, by both the Parliament and Government (as an authorised legislative forum by virtue of Article no. 115 in Romanian Constitution), creating the illusion of a legislative effervescence.

The statistics regarding the normative activity of Romanian Parliament and Government for the past 5 years confirm these conclusions. According to the data provided by the Centre of Institutional Analysis and Development, in 2010 there were adopted 223 laws and 122 Government ordinances, in 2009 there were adopted 391 laws and 138 ordinances, in 2008 there were 307 laws and no less than 268 Government ordinances, in 2007, the Parliament adopted 383 laws, while the Government released 200 ordinances and, finally, in 2006, there were adopted 514 laws and 201 ordinances.

Moreover, these statistics underline the profound legislative instability, given the fact that 46% of the laws adopted in 2010 either modified or abrogated previous normative acts, and 20% of them modified or abrogated other recent laws and ordinances, adopted in the last three years.

Additionally, half of the Government ordinances from 2010 were adopted with the purpose of modifying the existent juridical system, while 15% of them modified or abrogated laws adopted in the last three years. For example, Law no. 571/2003 which refers to the Fiscal Code – a significantly important law that establishes the legal framework for taxes (which represent important revenues for the state and local budgets), the way they are calculated and their payment methods, as well the number and identity of taxpayers – has been modified 47 times during the past five years.

The above data also renders the large number of normative acts adopted by the Government, which takes advantage of the stipulations found in the constitutional article no. 115, and becomes a legislature, thus eroding the fundamental principle of separation of powers within a state. This situation is the result of a negligence, as the Constitutional Court did not sanction the breach of the emergency clause regarding government ordinances, which contravenes the constitutional specifications concerning parliamentary legislative power.

We consider that these frequent modifications of laws are caused by the lack of sufficient planning and scientific research during their elaboration process, which makes the legislator incapable of anticipating and counteracting the social and economical consequences resulting from their implementation. Neither anticipative impact studies, nor professional debates were conducted, contrary to the stipulations found in Law 24/2000, Article 7(3) regarding the norms of legislative techniques for the elaboration of normative acts, which underline the necessity of an impact evaluation of project laws before their actual enactment, while examining both the impact of laws in force at the moment of project elaboration, and the impact of public policies entailed by a given law project.

The current state of affairs is also the consequence of a malfunctioning Legislative Council which, according to the stipulations of Article 3 of Law 73/2003 with its subsequent amendments, should analyse and notify law projects, legislative proposals and Government ordinance projects, before they are approved and implemented; the Council should also analyse law projects and legislative proposals arrived after they were adopted by one of the Parliament Chambers, as well as elaborate studies for the

systematisation, unification and coordination of laws, together with examining their compliance with constitutional principles.

It is also necessary to mention a series of other factors which jointly generate vulnerabilities in the law and judicial system. Thus, the flawed and often interpretable legislative framework, together with a heterogeneous and contradictory practice regarding the cases brought to court, generates a slow resolution process, due to the intensive and profound activity of courts, causing the postponement of court decisions and generating moral prejudices caused by excessively lengthy trials.

For example, in the case of insolvencies or commercial litigations, the repeated postponement of court hearings from one year to the other negatively affects the business environment and economic development.

Moreover, long trials cause the overcrowding of courts (in 2010, in Courthouses, there was a load of 2010 court cases per judge, in Law Courts the load per judge was of 959 cases and in the Courts of Appeal, 696 court cases), undermining the effectiveness and impartiality of the judicial system and, consequently, the proper functioning of trade market activities.

Under these circumstances, the easy access of justice seekers to simple and effective judicial procedures and the acceleration of trial resolutions, even in cases of enforced judgements, remain simple desiderata.

The fundamental principles of civil lawsuits are not clearly rendered and, thus, they can be only inferred from constitutional norms or from the interpretations of certain texts found in the Code of Civil Procedure; these principles are rather a doctrinal creation, jurisprudentially sanctioned, than a legislator's act of will.

The citation and communication procedure of procedural acts is not adapted to current realities, nor to the target of assuring rapid and predictable court resolutions, in accordance with the fundamental principles of the civil code: the principle of contradictoriality and the right to defence (with the exception of using traditional means of communication based on law enforcement officers or other court employees, or through mail, there is no possibility to issue procedural acts using modern means of communication, such as telefax, e-mail or other communication means which ensure the transmission of texts and their confirmation of receipt).

Additionally, court postponements are not considered exceptional (this rule is expressed in Latin as *exceptio est strictissimae interpretationes* – which means that exceptions are construed restrictively and, when a juridical norm becomes an exception, this exception is not to be extended over other situations); on the contrary, disputing parties have the possibility to solicit and obtain repeated unjustified court postponements, which lead to the overcrowding of courts and negatively affect juridical activities. Moreover, there are no solid norms regarding case transfers and judge recusals, these insufficiencies being used as excuses to adjourn court trials.

Last but not least, the unpredictability of court resolutions represents another impediment for regular justice seekers, knowing that in our law system, unlike the Anglo-Saxon one, the jurisprudence and judicial precedent are not acknowledged *de iure* as sources of law.

We believe that the supremacy of law derives from the way it is implemented, not from the way it is written. The most important aspect of law is the effective functioning of the judicial system, not its potential power.

With reference to the functioning of the judicial system, in a report about the Romanian justice status in 2010, published by the Superior Council of Magistracy – institution responsible for ensuring judicial independence, as it is stipulated in Art. 133 (1) of the Romanian Constitution – there is mentioned a series of risk factors regarding the independence and effectiveness of the judicial system. The risks derive from the low level of allocated material and financial resources, from the lack of predictability and stability regarding the status of judges and prosecutors, from the increasing number of civil and commercial cases in courts etc.

We believe that the following example is revealing for the overcrowding level of courts:

- at Courthouse level, the total number of litigations deriving from civil juridical reports was of 317,952 (326,827 legal cases in the year 2009 and 328,933 in 2008), out of which 202,054 represent patrimonial legal issues (and out of these, 63,261 cases deal with property rights and other real rights), and the number of commercial litigations was of 310,174 cases (280,463 cases in the year 2009 and 162,909 in 2008);
- at Law Court level, the total number of litigations deriving from civil juridical reports was of 118,247 (94,022 legal cases in 2009 and 73,501 in 2008), out of which 64,639 represent patrimonial legal issues, and 24,875 of these deal with property rights and other real rights; the number of commercial litigations was of 147,629 cases (189,566 cases in 2009 and 158,595 in 2008), plus 75,567 bankruptcy files;
- at Court of Appeal level, the total number of litigations deriving from civil juridical reports was of 18,044 (17,503 legal cases in the year 2009 and 19,298 in 2008), out of which 9,529 represent patrimonial legal issues, and 7,638 of these deal with property rights and other real rights, plus a number of 28,058 commercial litigations (27,116 files in the year 2009 and 24,584 in the year 2008).

Moreover, a particular aspect that occupies our attention is the phenomenon of judicial corruption, which includes every attempt of influencing legal professionals and the impartiality of judicial procedures, with the purpose of gaining illegitimate benefits by either of the parties involved. Corruption manifests as a sum of pressure factors that cause a lack of integrity within the judiciary.

Among these factors we include the interference of politics in the recruiting and employment process of judges, in their payment process, as well as in the allotment of legal cases and in the appointment method of panels of judges (Dănileț, 2009).

Judicial corruption is encouraged by a series of favourable factors which refer to the organisation of courts on several jurisdiction levels, to the complexity of procedural aspects and their lack of transparency, to the non-existence of alternative institutionalised systems capable of solving legal disputes; as a consequence, judges monopolise judicial activities, the jurisprudence becomes flawed and the judicial system is undermined by certain groups of organised crime (Buscaglia & Dakolias, 1999).

Judicial corruption generates efficiency losses in *ex post* contract enforcement, affecting the economic performance of private organisations and leading towards a loss of trust in justice acts and social values, as court resolutions for civil and commercial cases become unpredictable.

5. Final Remarks

Even though our study provided some general observations regarding the incoherence of the Romanian law and judicial system and his consequences on economic performance, thus imposing further more complex studies, we are still able to define some negative aspects that require rapid improvements.

We are witnessing a legislative instability, caused by the increasing number of normative acts issued by the Government, which consistently undermines the legislative power of the Parliament, while the role of institutions such as the Legislative Council and Constitutional Court is being continuously diminished.

The flawed and often interpretable legislative framework significantly delays court resolutions, while it also affects their predictability and increases transaction costs for private organisations. Trial procedures are slow and ineffective, causing the overcrowding of courts and prorogation of court hearings. Last but not least, the Romanian judiciary is often subject to improper influences from the political sector, affecting directly or indirectly its judicial exercise, in parallel with the lack of integrity of the ones controlling the laws.

Thus, it is necessary to implement an anti-corruption policy, to enhance the predictability of the law-making process, to reconsider and restore the attributions of institutions involved in the Romanian legislative and judiciary process, in order to promote proper civil and commercial judicial procedures, together with the analysis of the possibility to acknowledge jurisprudence as a source of law.

Considering the facts presented above, in our view, the existence of efficient legal institutions, who enforce contracts *ex post* while using the judicial infrastructure (courts and judicial procedures), is more than critical for the formation of an agreement of will between contracting parties, thus generating economic performance for private organisations by reducing transaction costs and by limiting the opportunism of economic agents. Equity, predictability, transparency and reduced costs are advantages deriving from the legal enforcement of contracts, which stimulate competition and trade, while reducing the risks associated with different types of transactions.

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