

JUDICIAL PERFORMANCE:  
ITS ECONOMIC IMPACT IN SEVEN COUNTRIES

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This paper reports research that measured the impact of judicial system performance on national growth momentum in Argentina, Brazil, Canada, Peru, Philippines, Portugal, and Spain. The research in each country was initiated by the author and conducted by separate research teams between 1996 and 2002.<sup>1</sup> The research methodology was sufficiently common to permit cross-country comparisons.

The findings indicate judicial system dysfunction adversely effects national economic growth and development to a significant degree. For example, Brazil's rate of economic growth was computed as impeded by about 20% as the result of judicial dysfunction, with credit availability reduced by some 10%. Studies showed growth rate impairment at 35% in Argentina but nominal in Canada. Impairment was calculated at 23% in the Philippines and at 11% for Portugal. Comparable figures for Peru and Spain were not produced.

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These research results have not been made widely available, particularly outside these countries.<sup>2</sup> A primary objective of this paper is to make them better known to scholars, policy advisors and those seeking deeper understanding of the role of judicial systems in economic development. A selection of the survey instruments and research reports themselves has been assembled for ready access from a web site.<sup>3</sup>

This paper briefly describes the research and tabulates some of the major findings. It discusses some implications of these findings for institutional economics, judicial reform efforts, and further research.

In brief, the research shows that poor judicial performance costs a country dearly. Would this news not prompt citizens to press for improved judicial performance? Logic would suggest so, but even where the results have been well disseminated, reaction has instead been interested but mild. The reason may be simple. People in many countries, including particularly people in economically and politically powerful elite groups, prefer an alternative to judicial system recourse. They transact business largely within their social networks and thus have limited need for a judicial system that works well. The costs to the economy of this preference may be significant but are little understood. This points to a second objective of the paper, namely to encourage investigation of the extent and consequences of this preference for transacting within social networks.

## **Context**

Economists have gained an increased appreciation of the role institutions play in shaping economic behavior. At first, intuition fostered this appreciation. The research reported here

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<sup>2</sup> Some researchers changed positions and were unavailable to shepherd results to publication. In one country, political circumstances changed abruptly, making release of the findings ill advised.

<sup>3</sup> At [www.kreative.net/ipbenefits](http://www.kreative.net/ipbenefits).

supplies useful empirical support. It has begun to show the numerous ways a judicial system influences economic behavior. As with most such research, it invites still more.

Judicial system influence springs most readily to mind in relation to private commercial disputes. Yet for a more comprehensive analysis, it may be useful to consider at least five other areas through which judicial system performance extends a conditioning influence into a national economy.

- + The creation and integrity of *property rights*, whether public or private
- + The extent to which the judicial system disciplines *abuse of administrative discretion* by government officials
- + The extent to which the judicial system oversees the *quality of legislation*
- + The *credibility of public policy* in general
- + *Informal and criminal activity*

The research reported here begins to map and measure that influence. The surveys in Argentina and Canada specifically examined several of these areas.

In reflecting on these six areas, one can begin to see that an effective judicial system provides an institutional foundation for an array of other institutions. If this foundation is weak, presumably some if not most of those other institutions will suffer with consequent economic losses of several kinds. The phenomenon is chronic in many developing countries and even some developed countries.

## **Background**

The research reported here originated from discussions within the World Bank in the early 1990s. Bank officials were focussing on dispute resolution as an aspect of business performance in Brazil, Argentina, Peru and Chile. Limited survey work in those countries suggested poor judicial performance impaired business performance, presumably with broader

negative economic consequences, but some aspects of those findings were puzzling. Business managers seemed surprisingly untroubled that judicial systems worked poorly. Instead, they seemed to rely on other means to facilitate their transacting. The surveys uncovered “reputation” and credit checks as common approaches to transacting. Nonetheless, within the Bank suspicion grew that there was a broader but unidentified economic cost to poor judicial system performance.

At about the same time, privatization of state companies in Latin America was accelerating. This spawned academic conferences seeking to project medium-term consequences. A collateral issue arose concerning future rate regulation for what had been essentially public utilities. The author was invited to prepare a paper for one of these conferences regarding the ability of judicial systems in Latin America to oversee future rate making for such utilities.

Drawing from the internal World Bank discussions regarding dispute resolution, and pondering the rate setting issue, the paper grew to a more general consideration of the overall impact of judicial systems on economic performance.<sup>4</sup> Its central contention was that it would not be surprising to eventually find the penalty to growth momentum in a liberalizing economy is at least 15% if the judicial system functions poorly. At the time, that estimate seemed high. The subsequent research reported here has found higher figures.

In 1996, a two-day workshop was held in Washington to discuss that paper. Organized by the University of Maryland’s IRIS Center (Mancur Olson) and funded by the Tinker Foundation, it was attended by a mix of some 50 economists, lawyers, World Bank and Inter-American Development Bank staff members, businessmen, a federal judge, political scientists,

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<sup>4</sup> For an abbreviated version of the paper, see Sherwood, Robert M., Geoffrey Shepherd, and Celso Marcos de Souza, 1994, “Judicial Systems and Economic Performance”, in *The Quarterly Review of Economics and Finance*, Vol. 34, pp 101-116 . The full paper is available at [www.kreative.net/ipbenefits](http://www.kreative.net/ipbenefits).

and anthropologists. No consensus was attempted and no report was published, but after the extended discussion many expressed the view that judicial system performance probably has more impact on economic development than had been generally recognized and deserves greater attention.

The Australian Law Reform Commission, in its four-year review of Australia's federal civil judicial system,<sup>5</sup> based its methodology in part on the concept that judicial system performance is usefully judged by referring to its contribution to national economic growth. That yardstick was derived in part from the Washington workshop noted above.

### **Theory Considered**

The reports produced from each country include essays on economic theory. While there is quite naturally a fair degree of repetition in these statements, each has its own character, providing an array of fresh insights, arresting phraseology and unexpected turns of thought. By themselves they provide a valuable collection of writings for those interested in the economic implications of judicial system performance.

The essay on theory by Armando Castelar in the Brazilian report is becoming a minor classic. This pioneering writing is guiding further empirical research now in Brazil and elsewhere. The Peruvian essay is crisp and straightforward. It spells out many ways judicial dysfunction impacts business and reports earlier Apoyo survey findings. In the essay for Argentina, Adrian Guissarri builds from work by Olson and Niskanen to offer a second creative theoretical approach to measuring economic damage arising from judicial dysfunction. The Canadian report by Owen Lippert, less formal than the others, offers insights from a common law perspective. The sophisticated Philippine essay by Manoel de Dios serves to review and refine Castelar's thinking and builds an enlarged context from more recent economic writing.

The most recent essay, the one for Portugal by Celia Cabral and Armando Castelar, is probably the most articulate and nuanced of the essays.

### **Methodology**

The research was built from the perceptions of business managers. For the most part, they were selected at random and were representative of leading segments of their economy. In some countries they responded in face to face interviews. In Brazil, mailed surveys and supplemental telephone calls prompted their replies. The report for each country details the sample design and means used to gather responses.

The survey instrument was developed first in Brazil, then sharpened and adapted to local conditions in the other countries. Unfortunately, in Spain several key questions were omitted, making comparisons more tenuous. The most concise version of the survey instrument is perhaps the one developed for use in Argentina, while a particularly clear description of the survey instrument appears in the report for the Philippines.

### **Characteristics of the Samples**

The method for selection of the companies from which responses were sought varied with each country. Randomization predominated while details differed.

The survey in Brazil, which came first in time (1996-97), was designed by Bolivar Lamounier and Armando Castelar with IDESP as the sponsoring organization. They targeted manufacturing and service firms headquartered in the state of Sao Paulo, most of which conduct business nation-wide. Many operated throughout the country. Firm selection was refined to insure industrial sectors were reflected in proportion to their share of the domestic market. Thus, if steel companies accounted for 7% of industrial revenue, then 7% of the sample firms were randomly selected from that industry. Valid responses were obtained from 278 firms. The

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<sup>5</sup> See Australian Law Reform Commission, 2000, *Managing justice: A review of the federal civil justice system*,

responses were deemed reasonably representative of the manufacturing sector of the economy. Agriculture and finance were deliberately excluded.

The survey in Peru, completed in 1998, was done by Gabriel Ortiz de Zevallos and Hugo Eyzaguirre of Instituto Apoyo. They closely followed the design of the Brazilian research. A universe of about 700 firms was selected to represent the various sectors of the economy, including agriculture and mining, as well as manufacturing, commerce, services and others. The survey extended nationwide, although in Peru this means essentially firms located in Lima. After extensive efforts, 170 firms representing 12% of GDP responded. This sample was deemed broadly representative of the national picture. Indifference to the survey by many managers was sharply higher than in Brazil, perhaps an unexpected indicator of indifference to the judicial system.

In Argentina, FORES served as the responsible organization under the direction of Horacio Lynch. The survey departed from the Brazilian model in considerable detail but not in overall thrust. Adrian Guissarri analyzed the data and wrote the report. A professional survey firm garnered 200 responses from company managers in Buenos Aires and two provincial cities. The leading industrial sectors comprised most of the sample. Agriculture was largely excluded. An unanticipated finding was that commercial interest rates differ sharply from one city to another because performance of the local judicial systems differs noticeably.

The Canadian survey closely followed the Argentine version. This was done to achieve comparability. Nonetheless, certain terms presented difficulties. For example, “ordinary” in Spanish carries a somewhat pejorative meaning. The survey was organized by Owen Lippert, then with the Fraser Institute. The Canadian Corporate Counsel Association mailed the survey to its membership. This drew 100 responses from a representative sample of industrial and

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ALRC 89, available at [www.alrc.gov.au](http://www.alrc.gov.au). See in particular footnotes 155 and 156 of Chapter 1.

financial firms. In Canada, corporate counsel tend to play a leading role in corporate management and were thus thought to provide informed responses.

In the Philippines, the survey instrument was prepared by Manoel de Dios and Meilou Sereno of the University of the Philippines. A professional survey firm collected data from 320 firms. A team led by Dr. de Dios prepared the report. The firms were located in Manila and surrounding cities. They represented chiefly the services and industrial sectors, with a few agricultural firms included. The new Chief Justice of the Supreme Court took an active interest in the research project. The World Bank and USAID provided funds for this project. Going beyond the other countries, this report identifies those reforms within the judiciary that would do most to improve economic growth, noting that most can be achieved by internal governance.

In Spain, the project began when Jose Juan Toharia obtained an early copy of the Brazilian report through informal channels. Santos Pastor joined him later. Their version of the survey drew replies from 500 companies of various sizes. Agriculture was excluded by choice. To disseminate their findings, the ICO Foundation held a three-day conference in Madrid in October 2000 to discuss the economic consequences of judicial system performance. There, a leading Spanish business leader and former minister declared the judicial system is not a problem because companies simply add a “judicial premium” to their prices. Perhaps unwittingly, he put the issue in a nutshell.

In Portugal, the research was conducted by Celia da Costa Cabral with the collaboration of the Brazilian, Armando Castelar, and completed in 2002. A sample of 602 firms was used to reflect the industrial base. More so than in the other countries, the researchers teased out variations in responses derived from firm size. The survey also explored more deeply the respondents’ experience with litigation. The calculation of growth momentum losses drew from the work of Adrian Guissarri of Argentina and is probably the most sophisticated of the studies

in this regard. The report also compared its findings with those from Canada, Argentina, Brazil and Peru.

The reports of those who conducted the research sparkle with random, unexpected jewels. We catch glimpses of skewed economic activity in developing countries and the ways business managers circumnavigate judicial system weakness. Some of these glimpses appear innocently, almost without grasping their importance. For example, at page three of the Peruvian report, we read:

“In small, less developed societies, personal relationships are fundamental. Transactions are made between people who know each other, the reputation of the agents involved has a high value and informal rules are almost sufficient. This allows individuals to trade at a low cost. Nevertheless, for an economy to develop it is necessary that the market extend itself, implying a major dependence on impersonal relationships. In this context, the formal rules imposed by a third party in an exchange gain greater importance.”

## THE RESEARCH FINDINGS

The survey instruments sought information regarding the respondent and his or her company. They identified their position or office within the firm, then indicated their firm size, type of industry, annual revenue, number of employees, and business activity location.

Although the Brazilian research approach was replicated in the other countries, each team added refinements and clarified issues. Some survey instruments added question sets. For example, in the Philippines, the survey asked in detail about respondents direct experiences with litigation.

The survey instruments probed many issues. The responses provide a broad array of information, some of it repetitive, much of it divulging the unique situation of each country.

For example, the managers were asked the degree to which they viewed as useful various means to avoid litigation. The lists, which varied from country to country, included things like resort to alternative dispute resolution, arbitration, pre-negotiation credit reports and reputation checks.

The managers were asked for their views regarding the specific damage poor judicial performance was inflicting on the national economy. Here the lists, which differed by country, included things like higher interest rate spreads, curtailed investment, reduced foreign trade, higher prices charged government entities, reduced investment, and lower employment.

The managers were asked to identify whether there was business activity that would otherwise be appropriate for their firm but was not undertaken *primarily* because of poor judicial system performance. Here the list included such items as substituting machinery for labor, outsourcing functions that would otherwise be conducted within the company and the reverse, and dealing with firms and individuals outside their circle of acquaintance.

What follows is a highly simplified tabulation of a few major findings.

How Judicial Performance Ranked Among Common Business Problems

Respondents ranked in order of seriousness a given list of problems, such as inflation, burdensome taxation, government regulation, and labor strictures. The list included the performance of the judicial system. The lists, which again varied by country, were meant to reflect each business community's consensus perception of the problems they faced. Judicial system performance emerged as a middle- to high-ranking problem in most of the countries.

Brazil	of mid-level concern among 6 problems
Peru	of fairly high concern among 5 problems
Argentina	of mid-level concern among 9 problems
Canada	of negligible concern among 9 problems
Philippines	of mid-level concern among 8 problems

Spain [question not asked]

Portugal of third order concern among 7 problems

### Degree of Negative Impact on Economy and Firm

The responding business managers indicated the degree to which they felt the judicial system's behavior compromised performance of (a) the national economy and (b) their firm. Viewing the data generally, the managers tended to find a greater negative impact on the economy as a whole than on their firms, perhaps suggesting they felt they had found ways to reduce negative impact (the "judicial penalty") on their firms.

Percentage of respondents stating the judicial system has a great negative impact, some negative impact, or both, on:

	(a) the national economy			(b) the firm		
	<u>great</u>	<u>some</u>	<u>both</u>	<u>great</u>	<u>some</u>	<u>both</u>
Brazil	50%	46%	= 96%	25%	66%	= 91%
Peru			85%			41%
Argentina			93%			57%
Canada	0%	12%	= 12%	0%	7%	= 7%
Philippines	[ not calculated as such <sup>6</sup> ]					
Spain	[ questions not comparable <sup>7</sup> ]					
Portugal	17%	48%	= 65%	6%	34%	= 40%

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<sup>6</sup> In the Philippines report, component parts of the judicial system, - supreme court, appellate courts, etc. - were assigned relative importance for their impact on both the national economy and on the firm.

<sup>7</sup> The Spanish survey asked for the degree to which respondents agreed or disagreed with a series of statements that characterized the impact of judicial system performance on various aspects of the national economy including credit, employment, and investment. Still, by inference, the impact is fairly negative for the nation's economy. A strong preference for dealing with "friends" emerges from this question. No questions provide an impression of the impact on the firms themselves.

After building to this point, the respondents were asked what they would do differently if the judicial system performed at a fully satisfactory level. The list of choices included things like increasing investment in their own firm, hiring more people, expanding the business, adjusting firm size, and reducing prices. Quantification of these responses was sought. For example, if investment in the firm would increase, they were asked to estimate that increase by percentage of current investment. Sector weighted averages were calculated and are shown here.

Increases expected were the judicial system to function well:

	in investment	in employment	in business (sales)
Brazil:	13.7%	12.3%	18.5%
Peru:	9.4%	8.2%	20.4%
Argentina:	28%	18%	10%
Canada:	nominal	nominal	slight
Philippines:	6-11%	not reported	not reported
Spain:	[ no questions asked on these points ]		
Portugal:	9.9%	6.9%	9.3%

To the extent the survey samples can be taken as representative of the total economy, these percentages provide a way to roughly calculate potential rates of national growth increases that well-functioning judiciaries would imply.

Several methods were applied to produce such rough estimates of the impact of judicial system performance on national economic growth. The penalty to growth momentum caused by judicial dysfunction was thus found at:

Brazil	20-25%
Peru	data available but not computed
Argentina	35% - computed using two methods

Canada	2.5%
Philippines	computed as 0.25-0.46% loss to annual GDP
Spain	data not obtained
Portugal	11%

For Brazil, the penalty was found by applying a simply growth model to the projected increase in investment. For Argentina and Canada, the penalty determination used a formula that computed the effect of both the indicated increases in investment and employment combined with resulting total factor productivity. The Argentine calculation also took historical growth patterns and “informality” into account. For the Philippines, a conservative approach produced a range of penalties depending on various assumptions. Although stated in different terms, the finding is comparable to the result in Brazil. For Portugal, a sophisticated approach comparable to that used in Argentina and the Philippines produced the 11% figure. No data was sought in Spain from which these increases could be determined. However, 85% of the responding Spanish companies stated that poor judicial system performance rendered them non-competitive in the European market, indicating a severe economic penalty. Although the relevant data were collected and are available, the penalty was not calculated for Peru.

In part, the methodology used valuation techniques. Company managers were asked to state how they would conduct business under a well-functioning judicial system, for many a hypothetical situation. The validity of valuation techniques has supporters and detractors, of course. It can be observed that business managers are practical and equipped by experience and necessity to make judgements about their likely future behavior in response to altered circumstances.

To serve as a check on the survey of business perceptions, several “in-depth” case studies were conducted in Brazil. One probed import-export executives on the issue of judicial system

impacts. Most of these managers had direct knowledge of judicial systems in the United States and Europe. The findings from that case study were substantially similar to the broader survey results.

Drawing from the research findings in Brazil, Armando Castelar and Celia Cabral subsequently calculated that credit availability in Brazil is reduced by about 10% as a consequence of judicial dysfunction.<sup>8</sup>

## **IMPLICATIONS**

What follows are selected implications of these findings for comparison studies, institutional economics, and judicial reform efforts.

### **Cross-country Comparisons**

As noted, the research methodology was sufficiently common to each of the countries to permit cross-country comparison of findings. No attempt is made here to draw more than a few of the possible comparisons available from the findings.

In defining what constitutes poor judicial system performance, a major challenge faced by the researchers was to think through whether particular sources of poor performance were internal or external to the judicial system itself. Conclusions differed by country. The report of the Philippines research articulates this nicely. For example, in the Philippines the public is badly split on major policy issues which, therefore, remain unsettled in the constitution itself, and when the Supreme Court renders decisions on those issues, it bears the brunt of criticism from half the population. Judicial system performance was found handicapped across the seven countries by externally caused factors such as insufficient resources for the system, legislative quirks, and unduly opportunistic behavior by members of the legal profession. As the research

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<sup>8</sup> Castelar, Armando, 1998, "Credit Markets in Brazil: The Role of Judicial Enforcement and Other Institutions"

methodology evolved, the term judicial system dysfunction was used often to roughly identify poor performance resulting from causes within the judicial system.

The survey instruments progressed through a sequence to questions that required the respondent to state how firm behavior might change were the judicial system to perform at a fully satisfactory level. Pilot testing showed responses were sensitive to the way these questions were phrased. In Brazil, Argentina and Peru, the researchers adopted reference to “performance at a first world level.” In the Philippines, reference to the systems of Singapore and Hong Kong was used to indicate the same thought. In Canada the phrase was “to achieve optimum performance” in the judicial system. The instrument in Portugal utilized the phrase “the level of the larger (maioria) of the European Union countries.”

Several general observations are readily available. There is considerable contrast between the situations in Canada and Argentina. Canada’s legal system includes both common law and civil code jurisdictions, whereas Argentina is a civil code country. The two countries were chosen for comparison because of similarities in their economies. Among other factors, both are “newly settled”, agriculture plays a large role in both (although the sample largely excluded agricultural firms) and they have roughly the same population. In recent decades their judicial system performance has become quite different, however, and their recent growth momentum is sharply divergent.

To degrees that differed by country, the business managers were indifferent to judicial system performance as it affected their firm activity, although perhaps for different reasons. The Canadians seemed unconcerned because the judicial system there is felt to work quite well. They do not see the judicial system as inimical to their activity. In each of the other countries, while respondents indicated they believe judicial dysfunction harms the national economy, they signaled noticeably less harm to their own firms. This appears to imply they have some degree

of confidence in their ability to pursue economic activity without recourse to, or even in spite of the judicial system. The basis for this confidence was at least partially revealed by the questions that probed for the techniques they apply to avoid the judicial system. These techniques varied somewhat from country to country and might suggest issues for comparative study.

The report for Peru points out that while business managers believe themselves able to deal with judicial dysfunction, they have a somewhat limited awareness of the (often hidden) costs their firms incur in doing so. Checking credit carries a cost in fees and time. Dealing only with “friends” reduces competition and forecloses options. Opportunities foreclosed will mean business is reduced.

### **Implications for Institutional Economics**

The reported research was designed to uncover the perceptions of business managers with regard to judicial system influence on investment, credit terms and employment, three factors that directly reflect growth momentum. No effort was made to explicitly search for the economic consequences in two other arenas. One is weak judicial discipline of the abusive exercise of administrative discretion by public officials. The other is feeble judicial oversight of the quality of legislation and administrative regulations. In both arenas the extent of economic damage may be significant. Still, the survey instruments were phrased broadly enough that respondents could have considered those arenas in giving some of their answers.

The economic consequences of judicial system dealings with informality and criminal behavior would provide another arena for deeper investigation. The role of judicial system performance in relation to assuring policy credibility may be greater than the authors of that literature recognize and here again deeper investigation could be rewarding.

It is difficult to speculate about how the findings in the seven countries would differ were their agricultural sectors added to the calculations. Except for Peru, the reported research

deliberately excluded the agricultural sector, and even there the coverage was slim (nine firms out of 170). Fresh research being proposed for Brazil will begin to fill this gap. Further research in the other countries would enrich the findings to date.

### **Implications for Judicial Reform**

The reported research highlights judicial system performance as a major pocket book issue for everyone, particularly the elite. The magnitude of the pocket book effect appears to be significant. It is likely that a similar effect would be found in many other countries.

For several decades, judicial reform has been driven by concern for ethical and moral considerations, human rights, civil rights and questions of access. While these are certainly valid concerns, they do not appear to have materially advanced judicial reform.

Judicial reform may gain momentum as it is increasingly seen as a pocket book issue. Still, the seemingly comfortable practice of dealing within social networks is likely to blunt that force until the costs of that practice can be shown. In a palpable way, reliance on social networking is being undermined in many countries by human migration, regional integration, new technology, global trading and capital flows.

Judicial systems and social networking can be viewed as competing institutions. A comparison of their relative costs and benefits, once elaborated, should enhance efforts to improve judicial system performance and thereby assist in advancing economic growth and development. The new institutional economics is developing the tools and experience to elaborate these comparative costs and benefits. The research reported here contributes to a basis for going forward.

### **FURTHER RESEARCH**

A judicial system that works well permits strangers to deal with each other. It constrains arbitrary government action and fosters public order. From the author's experience in many countries, it appears that where judicial system performance is poor, transacting (other than "spot" and "capture" deals) tends to be done within personal networks. These networks may consist of clusters of elite families, church-based groups, social trust groups, single villages or neighborhoods, ethnic groups, extended families, or various other types of "clans". Everyone has a social network, even the poor man who operates in a back alley. Some networks are more elegant and well-defined than others.

The mix of such social networks varies from country to country. In some, these networks are quite sophisticated and selective, while mixed or fractured in others. In some countries, as in Brazil, traditional land-based social networks in the North and ethnic networks in the South are breaking down as population migrates to cities like Sao Paulo. There, for example, litigation per capita has risen sharply in recent decades.

Transactions within social networks tend to need to be very high return investments to warrant the risks involved, whereas many investments for more "ordinary" returns are usually not undertaken in a social network system. This could represent a large loss for social network countries. Measuring that loss presents a challenge.

It is interesting to note that the Australian Law Reform Commission, during its review of Australia's federal civil judicial system, found that a large percentage of cases entering the system never reach formal adjudication, but are apparently abandoned or settled by the parties in some fashion. We can reflect that once parties get into a dispute under either a judicial system or in a social network system, they tend to get resolved in about the same way. That is to say, the judicial system exerts its own pressure to settle disputes, perhaps somewhat like the pressure

within a social network. However, the pressure to settle that exists within a judicial system functions well only when that system works well.

The behavior resulting from social network transacting, in substitution for judicially supported transacting, would appear to have significant but as yet unmeasured economic implications. A threshold issue involves finding ways to measure the magnitude of social network transacting within an economy. Then ways to measure the costs to an economy arising from barriers to entry, sub-optimal allocation of resources and other social networking consequences will be needed. The result would be quantification of damage absorbed by an economy that depends heavily on social networking.

Regional integration is probably also impaired to some significant degree by the preference for social network transacting. The incorporation of some of the former Soviet Union countries into the European Union would serve as a useful arena for such research. Historically, many of these countries have functioned primarily through social network transacting. For most purposes, the social networks that function within these countries do not extend into the other countries of the EU. By how much does this impair capital flow? By how much is trade constrained? What happens to the movement of labor? These again supply useful challenges for institutional economics.

Given the seven-country research described here, it appears that much can be learned by further study of the preference for social trust networking, its impact on national economic performance and on efforts to strengthen judicial system performance.

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