

Limitation of legal governance and role of private institutions: Some historical examples

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Since the seminal work of North and Thomas (North and Thomas[1973]), economists and economic historians have understood that the property right is a prerequisite of economic development. While North and Thomas[1973] focused on the property right enforced by the state, there have been various private institutions which played the role of property right enforcement (Greif[1993, 1997, 2003]; Aoki[2001]). It is remarkable that many of those institutions emerged to supplement the bounded capability of the legal system. When activities of the private sector rapidly expanded, or a new type of activities developed, the existing legal system often failed to govern those activities effectively, and private institutions filled the gap. In this paper, I will present a couple of examples in the Japanese economic history.

It is well known that the Japanese economy grew fairly fast in the seventeenth century. From 1600 to 1700, the population and rice production increased 2.31 times and 1.55 times, respectively (Hayami and Miyamoto[1988]). Besides the agricultural production, the commerce and trade substantially developed. The expansion of economic activities went beyond the capacity of the government (*Bakufu*). In those days, law suits in the Edo (the old name of Tokyo) area were processed by the governor of Edo (*Machi Bugyo*). In 1718, 47731 suits were filed to the governor, 33037 of which were on commercial issues (Oishi[1998]). On the other hand, the number of the officials under the governor was around three hundred. Also, they took in charge of not only legal law suits, but also administrative affairs.

Faced with the huge number of law suits, in 1719 the government announced the *Aitai Sumashi Rei*, which prescribed that commercial suits would not be accepted and those affairs should be resolved between the concerned persons. The *Aitai Sumashi Rei* was announced ten times in total in Tokugawa Era (1603-1868). It implies that the scale of commercial activities grew to be too large for the government to govern. In this situation, a private institution supplemented the governance function of the government. That institution was *kabu nakama*. *Kabu nakama* was a coalition of merchants or artisans, organized basically by commodity and by region. In many cases, *kabu nakama* had a code prescribing that all the coalition members should suspend trade with a counterpart of the commerce who cheated one of the members. This is

similar to the Multilateral Punishment Strategy, MPS), formulated by Greif[1993] with respect to the Maghribis traders in the Medieval Mediterranean society. Okazaki[2001] confirmed that *kabu nakama* effectively governed the commerce by the MPS, comparing the performance of the economy in the period when *kabu nakama* was banned by the government (1842-1850) with the performance in the period when *kabu nakama* worked. When *kabu nakama* was banned, the performance of the economy substantially declined, due to credit crunch and disorder of the distribution system.

The case of *kabu nakama* is an example that a private institution supplemented, so to speak, quantitative limit of the government capability. On the other hand, in the next case, a private institution protected the right which the legal system was not expected to protect (Hereafter, I rely on Nakabayashi[2001]). In the late nineteenth century, the silk reeling industry in Suwa area was faced with a serious labor poaching problem. As the cost to recruit a female worker from a distant agricultural area to Suwa area was substantial, silk reeling companies had incentives to poach workers from other companies. Therefore, many conflicts concerning labor poaching occurred among silk reeling companies. However, the court could not directly intervene with those conflicts, because the Civil Law did not recognize the right of the company which paid the cost of recruiting a worker from the agricultural district. This was because the modern common law, in general, does not recognize the real right with respect to a person. It was possible that the labor market in Suwa area would decline due to this market failure.

In this situation, an organization of the silk reeling companies in Suwa area, the Suwa Silk Reeling Association was established in 1900. The major function of the Association was to register workers of the member companies. If a registered worker of company A transferred to company B, the bureau of the Association gave company A the credit for the right to employ a worker. The credit could be offset with the credit from B to A. Also the credit could be sold to the third company. Based on this private institution, the labor market in Suwa area was effectively governed, which, in turn, brought about expansion of the labor market and growth of the silk reeling industry.

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