

Role of Courts in Economic Development: A Case of Prewar Japan*

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Abstract

In this paper, we explore the role of courts in the Japanese economic development, using prefecture-level litigation statistics. Since the late nineteenth century, the Japanese people brought many cases before the courts. The dominant part of the cases dealt with monetary issues, which implies that the court played a substantial role in arbitrating disputes related to economic transactions. Through regression analyses of prefecture-level panel data, it was found that frequency of law suits was positively correlated with the scale of economic activities, but that it was only in case economic development was accompanied by urbanization or decline of local communities. At the same time, it is found that increase of the capacity of the legal system enhanced financial development. In this case also, the importance of the capacity of legal system was conditional on the function of local communities.

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1. Introduction

Since the seminal work by North and Thomas (North and Thomas 1973), most economists and economic historians have agreed that the protection of property rights is essential to the development of a market economy. Whereas North and Thomas (1973) focused on protection of property rights by the state, in recent years, it has been stressed that the ways of providing such protection are diverse and not limited to the state (Ellickson 1991; Fauchamps 2004; Dixit 2004; Greif 2006). Nevertheless, it is true that the state, more specifically, the courts, have played a significant role in property right protection in the modern period.

However, surprisingly, there are few historical studies exploring the role of the courts in modern economic development¹. One exception is Muldrew (1993). Examining the records of a borough court in early modern England, he found that the court was accessible to almost everyone in society, wealthy or poor, for settling disputes including those related to economic transactions. Another exception is George and Sworden (1986), which drew on court decisions regarding contract and property law in early nineteenth century Canada, to conclude that the court played an important role as infrastructure to enhance economic efficiency. On the other hand, in the Japanese context, based on the records of court decisions, Nakabayashi (2001) argued that the decisions of the ward court in Suwa district supported the grade wage system, in which the wages of each worker were determined based on her relative performance, and thereby contributed to the emergence of the labor market in that district.

However, much remains to be done in the area of historical research on the role of the courts in economic development. In particular, given the state of the literature, it is important to take a bird's eye view of the relationship between economic development and the role of the courts. Japan provides an excellent basis for this research. In Japan, the modern court system started in 1875, when the Supreme Court was established. Since 1878, the Ministry of Justice has published detailed litigation statistics, the Statistics of Civil Cases (*Minji Tokei Hyo*) every year (Hayashiya 2003; Hayashiya et al 2005). Using these statistics as well as other relevant economic data, we explore how economic activity affected demand for court services, and how the legal service supported economic, in particular, financial development.

This paper is organized as follows. Section 2 provides an overview of the history of the legal system in Japan since the ancient period. Section 3 describes the basic

¹ Concerning pre-modern period, Greif (2006) analyses the role of community courts in the context of the community responsibility system.

features of civil law suits based on the Statistics of Civil Cases. In section 4, we explore the relationship between the legal system and economic development quantitatively. Section 5 concludes the paper.

2. A brief history of the legal system in Japan

The legal system in pre-modern period

From the late seventh century to the early eighth century, the Imperial Government of Japan tried to transplant Chinese political institutions along with its legal system. In that period, the Imperial Government proclaimed “Imperial Legal Codes,” (*Ritsuryo*) written in Chinese, which were modified versions of Chinese Imperial Legal Codes. In 710, a landmark code, the “Imperial Codes of Taiho,” was proclaimed, and this formed the basis of the legal system in the ancient empire of Japan.

In this empire, the ruling elites were the Imperial family and nobles, led by the Fujiwara clan, which was responsible for compiling the “Imperial Codes.” The property right to any piece of land in Japan officially belonged to the Emperor, and the legal system was also officially centralized. In reality, however, the Imperial Government did not have sufficient resources to rule the entire country, and therefore delegated the responsibilities of government and the authority to collect taxes to the Imperial family, nobles, and major temples, which held manors. The de facto decentralized manor system was the basic political structure of Japan at that time.

Furthermore, in rural communities where agriculture was practiced, the owners of the manors did not exercise their powers directly. Rather, they delegated the responsibility to govern local communities, along with the right to collect certain rents as a portion of the taxes, to local elites and low class nobles. Because of the nature of their tasks, these people were heavily armed, and came to be called “*samurai*”². While the Imperial Legal Codes held sway in the Imperial Capital, Kyoto, in the western part of Japan, and in neighboring regions called *Kinai*, the *samurai* followed their own common law in other areas.

By the twelfth century, the local *samurai* formed several groups, and each group was led by a samurai of noble origin. After a period of civil war among these groups, in 1192, the Kamakura Shogunate, a samurai-based government, was finally established at Kamakura in the eastern part of Japan, while the Imperial Government at Kyoto still existed and played the role of giving legitimacy to the Shogunate³. The Kamakura

² The original meaning of samurai is a person who served his lord.

³ “Shogun” was a title meaning “general,” and was conferred by the Emperor.

Shogunate created its own court, where samurai common law was applied. In 1221, retired Emperor *Gotoba* stood against the Hojo clan in an attempt to overthrow the Shogunate. This attempt failed and led to the power of the Shogunate being expanded to Kyoto. Furthermore, in the late thirteenth century, the Mongolian Empire attacked Japan. By repulsing it, the Shogun took over foreign affairs and defense, which gave the Shogun the basis to rule all of Japan including the West, where the Imperial Government had formerly been relatively powerful. In 1223, the Shogun proclaimed the “Legal Codes of Joei (*Joei Shikimoku*),” which constituted the first written text of samurai common law, and the first law written in Japanese. By the thirteenth century, samurai common law replaced the Imperial Legal Codes to become Japan’s official legal system. Thus, the legal basis of the feudal state was established.

The legal system in Tokugawa Japan had its origin in this samurai common law. The common law governing the relationship between feudal lords and the samurai became highly sophisticated through fourteenth and fifteenth centuries, and this was incorporated into the political and legal system of the Tokugawa Shogunate. In the Tokugawa period, feudal lords were strongly controlled by the Shogun, and the samurai became merely civil servants hired by feudal lords. In this sense, the political system of Tokugawa Japan was a centralized one.

With respect to the general public, however, the system was substantially different. Farmers were given a high level autonomy over their economic and social activities. Even tax collection from farmers was delegated to villages, which were self-governing. At the same time, most contracts between farmers were written and enforced by the farmers themselves. “Private” agreements were signed or sealed by village officials selected from among farmers, relatives, and neighbors, so that “private” agreements had formality. Here enforcement was carried out by members of the village, not by the Shogunate (Henderson 1975, p. 31.).

In other words, the Tokugawa Shogunate was not obliged to provide legal services for civil cases, while it was obliged to try criminal cases to maintain peace and order, which had long been the duty of the samurai class. With respect to civil cases, the Shogunate differentiated between two kinds of claims; namely, claims with security and claims without security. Suits for claims with security were generally heard by the Shogunate court, but suits for claims without security were not necessarily accepted by this court, especially when it was busy (Henderson 1975, p. 32.). Indeed, when the Shogunate court was very busy, the Shogunate proclaimed “*Aitai Sumashi Rei*,” which literally means “order for parties to settle conflicts by themselves”. In this sense, bringing civil law suits was not a “right” under the Tokugawa regime.

However, the protection of property rights is essential to the development of a market economy (North and Thomas 1973; North 1990), and indeed Tokugawa society was characterized by having a highly developed market economy (Shinbo and Hasegawa 1988). Then the question is how that condition was satisfied.

As tax collection and enforcement of agreements within a village were delegated to the village, the defense of claims without collateral, or governance of trade to prevent cheating, was delegated to the merchant's guilds, called "nakama", which means "a group of colleagues". Usually a nakama would cover all the relevant merchants in a certain area, so that a nakama could exercise monopoly power for a specific industry in a certain geographical area.

The Tokugawa Shogunate identified some important nakama in big cities, and ordered them to pay taxes in return for guaranteeing their monopoly privileges in those cities. These privileged nakama were called kabu nakama, which meant chartered groups as they held a 'kabu' or business license. These guilds were delegated the authority to manage their own trading affairs, and jurisdiction over trade-related claims was given to these guilds (Okazaki 2005). While large nakama in big cities had such privileges, many small nakama in local cities and villages also had jurisdiction over their own areas of trade.

As long as trading transactions were repeated among the same partners, i.e., trades were personal, such private governance worked well. Cheating your partner meant losing the profit that would have accrued from numerous personal trades in the future, so that honest trading today can be seen as the outcome of the sub-game perfect equilibrium strategy, if the expected value created from personal trades was sufficiently large (Okazaki 2005; Greif 2006).

However, such a private governance mechanism does not work for impersonal trades, because a partner today might not be important tomorrow. Remarkable economic development in a modern nation state has come from, at least partly, impersonal trades under the price mechanism. Property right protection backed by the modern state was critical, not only because a centralized modern state had strong powers of enforcement, but also because it re-established effective rights for any third party, i.e., effective in impersonal transactions, by defining rights as universal within the state, and by declaring that these rights would be protected by the state against anyone who challenged them (North 2005). The Tokugawa Shogunate provided legal services for criminal cases and assumed responsibility for maintaining peace and order. This clearly stimulated a degree of economic development, but it could not establish a right protected by the state. For institutional change from personal privilege to

impersonal rights, a modern legal system was needed.

Introduction of the Western legal system

After a 260-year policy of isolation, in 1854, the Tokugawa Shogunate was forced to establish diplomatic relations with the US in response to a military threat from the US, and then with other Western powers. In 1858, the Tokugawa Shogunate again had to conclude a treaty of friendship and commerce with the US, and then with other Western powers. Under the treaties in 1858, Japan was forced to enter into a free trade regime from 1859. This sudden immersion in a free trade environment caused major changes in relative prices in the Japanese economy, which were perceived as chaotic by the general populace (Shinbo 1978; Bernhofen and Brown 2004). Also, Japan had to approve consulate jurisdiction to Western countries under the 1854 treaties, and to give up tariff autonomy under the 1858 treaties. National security was the duty of the samurai class, but the Tokugawa Shogunate apparently failed to achieve it. The trust the Japanese people had had in the Shogunate rapidly disappeared.

In this situation, a number of powerful feudal lords supported by the Emperor defeated the Shogun in 1868, and immediately declared the establishment of the “New Imperial Government.” This initiated the radical political institutional reform referred to as the “Meiji Restoration.” One of the important goals of the New Imperial Government was to renew “partial treaties” with Western countries. However, lack of a modern legal system, thus lack of human rights including property rights, was used as a good excuse by Western countries for refusing to renew these treaties. This attitude on the part of Western powers compelled the new government to try to introduce a Western-style legal system.

In Tokugawa Japan, a registered farmer exclusively held a piece of land and cultivated it. His right to holding that piece of land was guaranteed by the feudal lord of territory in which he lived, in exchange for his duty to pay taxes. The tax rate was fixed, for example, 40% of the crop, and after paying this tax in kind, the rest of crop belonged to the farmer. In the sense that the surplus after taxes belonged to the farmer, he “owned” his land. However, the buying and selling of land was officially prohibited, so that even if he could actually sell his farm to somebody, the Shogunate court would not endorse the contract. In 1872, the New Imperial Government officially allowed land to be bought and sold. Furthermore, in 1873, the New Imperial Government started the “Land Tax Reform,” by which any holder of land was registered as the exclusive owner in the modern sense, and he had to pay taxes in money. While the property rights of farmers were authorized by the New Imperial Government, the dominium of feudal lords was “returned” to the Emperor in 1870, and feudal independent states were

turned into prefectures that did not have independent sovereignty.

In 1873, the New Imperial Government invited Gustave Emile Boissonade de Fontarabie, a law professor at the University of Paris, and started formulating the Civil Codes and the Commercial Codes with the professor's help, and also consulted him on the formulation of the Criminal Law. In 1880, the Criminal Law, the first Western law in the Japanese legal history, was proclaimed and came into effect in 1882⁴. The Civil Codes and the Commercial Codes based on French law were proclaimed in 1890, and were then modified by the introduction of German elements before they were enacted. The Amended Civil Codes, the first half of which was proclaimed in 1896, and the latter half in 1898, were enacted in 1898. The Amended Civil Codes were proclaimed and enacted in 1899.

Centralization by the New Imperial Government caused antipathy among farmers and ex-samurai. Furthermore, within the New Imperial Government, there existed a serious divide between the Emperor and nobles and the young civil servants led by Hirofumi Itoh. The Emperor and nobles wanted "restoration" of imperial monarchy, but well-educated civil servants were eager to establish a modern constitutional state. There was unrest outside of the government, and the "Movement for Freedom and Democracy" favored the latter course. In 1875, the New Imperial Government issued an ordinance that the government would "gradually move to becoming a constitutional state." Hermann Rösler, a Prussian scholar, was invited, and Itoh and other young civil servants began study on constitutional law with him. Right after the Meiji Restoration, the highest nobles, whose role it was to support the Emperor, were appointed to the positions of prime minister and deputy ministers. However, Itoh established the modern cabinet system in 1885 to replace them. In 1889, the New Imperial Government proclaimed the Constitution of the Empire of Japan, which followed the Prussian constitution in many respects. Under the Imperial Constitution, which remained in effect from 1890 to 1947, protection of property rights and freedom of contract were guaranteed as fundamental civil rights. The Constitution, along with the Civil Codes and Commercial Codes, constituted a fully detailed rule book for the market economy.

Development of legal organization and accumulation of human capital

While the modern legal system was established in Japan in the 1890s, ordinances and laws that could be considered fragments of a modern legal system had been introduced since the early 1870s. For instance, the 1872 National Bank Act, a

⁴ In 1907, Japan's Criminal Law underwent major revisions following the "New School of Criminal Law" in Germany. These revisions have remained in effect since 1907.

copy of its American counterpart, provided a model for a joint stock company, and indeed the stock exchange played a significant role in Japanese industrial revolution from the 1880s. The 1890s was the period when all of these modern legal institutions were consolidated.

The court system was not an exception. The Court Organization Law, the Civil Lawsuit Process Law, and the Criminal Lawsuit Process Law were proclaimed and enacted in 1890. But formation of the legal system had started in the early 1870s. In 1872, the New Imperial Government established the Department of Justice, which was the first effort to make the judiciary relatively independent within the administration, and the Ordinance of Civil Servants was introduced, by which civil servants belonging to the judiciary, such as judges and prosecutors, were separated from others. In 1875, when the government declared the gradual transition towards a constitutional state, the Supreme Court (*Daishin In*) was established as an organization fully independent of the administration. In 1886, immediately after the Cabinet Organization Ordinance was proclaimed, the Court Organization Ordinance was proclaimed, marking the completion of the implantation of the basic structure of a Western court system.

Once the Criminal Law, Constitution, the Civil Codes, and the Commercial Codes were proclaimed, legal studies on how to apply them to the Japanese situation flourished. In the 1890s, the fundamental studies that have remained [relevant][pertinent] until the present day were produced. The Department of Law of Tokyo Imperial University was the center of these studies, and it supplied the government with a new generation of judges, prosecutors, and bureaucrats. Many private law schools were also established, which became a source of lawyers for the private sector. In the late 1890s, a consistent rule book on the market economy and the human resources to implement it were now in place to facilitate impersonal exchanges in the market.

3. Economic development and the role of the courts: A descriptive analysis

In this section, we give an overview of the basic features of civil law suits and the relationship between law suits and economic activity, using the data from the Statistics on Civil Cases (*Minji Tokei Hyo*). As stated in the previous section, the Japanese court system was composed of four tiers, namely the Supreme Court, high courts, district courts, and ward courts. With respect to civil cases, the ward courts were in charge of holding the first trial for suits where no more than 100 yen was at stake and compromises. In 1895, there were 301 ward courts under 49 district courts (Table 1). In 1913, due to curtailment of government expenditure, 128 ward courts were abolished,

but 46 of these courts were revived in 1917 and another 31 in 1919 (The Supreme Court 1990, pp.113-114). In terms of the number of suits accepted, ward courts played a dominant role. That is, more than 80% of the cases were accepted at ward courts (Table 1).

Figure 1 shows the number of civil cases disposed at ward courts from 1891, the year following the introduction of the Code of Civil Procedure. In terms of total number, trends and cycles can be identified. Namely, the total number of suits showed a clear upward trend. It increased from 155,913 in 1891 to 285,707 in 1929. At the same time, the number of suits changed cyclically, which suggests that the number of suits was associated with the business cycle. To see the relationship between the cyclical changes in the number of suits and the business cycle, Figure 2 shows the annual percentage changes in the number of law suits (Panel A) and the diffusion index of Fujino and Igarashi (1973)⁵ (Panel B). Concerning the number of law suits, the series of newly accepted cases as well as that of cases disposed of are shown. The two series follow a very similar pattern. The diffusion index is a composite index of time series data on economic activity used to identify the business cycle. Comparing Panel A and Panel B, we find that the percentage change in the number of suits was basically counter-cyclical in the prewar period. In other words, it was negatively correlated with business. The correlation coefficient of the percentage change in newly accepted suits and the diffusion index is -0.40 in the period from 1892 to 1929.

As seen in Panel A, the growth rate of suits was positive in most years, but there were three distinct periods when the growth rate for the number of suits was continuously negative, namely 1893-1896, 1904-1907 and 1916-1920. The first period includes the boom after the Sino-Japanese War that was boosted by government expenditure based on the reparation money from China. The second period includes the boom after the Russo-Japanese War. Although Japan could not get any reparation money on this occasion, due to the impact of the war, heavy industry and the chemical industry started to grow. Finally, 1916-1920 is the boom period during the First World War. As the production capacity of the Western countries was taken up by munitions, the Japanese economy enjoyed huge export-led prosperity. At the same time, the heavy and chemical industries expanded substantially by substituting for imports from Western countries. These three booms were followed by depressions. During these

⁵ Fujino and Igarashi (1975) developed several diffusion indexes. The series in Panel B is “the diffusion index based on normalized percentage change from the same month of the previous year” (pp.128-129). In Panel B of Figure 2, the index in each December is plotted.

periods of depression, the growth rate of law suits went up and stayed at a high level⁶. The counter-cyclical pattern of law suits arguably reflects the pattern of defaults in the business cycle. This conjecture is consistent with the composition of the suits outlined below.

Figure 1 also indicates the composition of civil suits disposed of at ward courts. *The Statistics on Civil Cases* classified civil suits into eight categories, namely personal, land, buildings and ships, monetary, rice, commodities, securities and others. The proportion of suits on monetary issues stayed at around 40% from the 1890s to the 1910s, and it went up to around 50% in the 1920s. The above mentioned trend and cycles in relation to the total number of civil suits were basically due to the proportion of suits dealing with monetary issues.

Monetary issues were further divided into many subcategories. The classifications adopted in the *Statistics on Civil Cases* did not remain exactly the same across time, and it is sufficient for the purposes of this study to see a general outline. Table 2 shows the subcategories for monetary issues for which the number of cases was not less than 1,000 in 1895 and 1925. In both years, the largest subcategory was that for loans, followed by sales credit including “bills⁷.” We can safely assume that a large proportion of the suits on monetary issues were related to credit in a broad sense, including loans and sales credit. In other words, credit was a major source of disputes that the Japanese brought before the courts in the prewar period. On the other hand, it has been made clear that, in general, the exchange in which *QUID* is separated from] *QUO* is essential to the expansion of a market economy, and to bring this about contracts need to be enforced in some way (North 1990, 2005; Greif 2006). Table 2 indicates that the courts played a substantial role in contract enforcement in Japan, at least from the late nineteenth century.

A remarkable characteristic of *Statistics of Civil Cases* is that it contains law suit data by area. The areas were divided according to the jurisdictions of district courts and ward courts. The jurisdictional area of each district court was basically each prefecture where the court was located, except for Hokkaido, and that of each ward court corresponded to a city or a county within a prefecture. While cases heard by

⁶ What seems to be an exception is the early 1910s. In this period, the diffusion index indicates that business had entered a prosperous phase, but the growth rate of law suits stayed at a high level. This may be due to the fact that this prosperous phase was weak, as reflected in the relatively low level of the diffusion index (Panel B). Indeed, this prosperous phase was referred to as “interim prosperity” at the time.

⁷ It is notable that the suits concerning sales credit became substantially larger from 1895 to 1925. It may arguably reflect the expansion of transactions with credit in this period.

ward courts are the focus of this paper, we have aggregated the data for the prefectural level. The collection of relevant data to be matched with suit data has been done for the sake of simplicity. Table 3 shows the number of law suits further aggregated at the provincial level to save space. In order to control for the difference in population across provinces, the per capita number of suits is also reported. The population data are taken from the Bureau of Statistics of the Cabinet (1907) and the Bureau of Statistics of the Ministry of General Affairs (2006). It is notable that there are substantial cross-sectional as well as time-series variations in the per capita number of suits. For example, in 1895, there were 2.82 times more law suits per capita in Hokkaido than in Chubu province. While law suits increased 2.45 times in Chugoku province from 1895 to 1925, they declined 0.89 times in Tohoku province in the same period. This cross-sectional and time-series variation in per capita number of law suits may allow us to explore the determinants of law suit “demand.”

As we have seen, most law suits were related to monetary issues, particularly to credit. This finding suggests that expansion of credit would lead to an increase in law suits. Figure 3 shows this relationship in 1895 (Panel A) and in 1925 (Panel B). The vertical axis denotes the per capita number of suits in each prefecture. The horizontal axis denotes the per capita amount of bills issued and settled by private banks in each prefecture. The data on bills are taken from the 1895 issue of the Bank Bureau Report and 1927 issue of the Japanese Imperial Statistical Yearbook. The amount is evaluated in terms of 1934-36 price by the price index by Ohkawa (1967). A positive correlation between per capita law suits and per capita bank bills is fairly clear in 1895 ($\rho=0.462$). In 1925, the positive correlation is not so clear, but it is still observed ($\rho=0.188$). The correlation between these two variables is consistent with the above conjecture that expansion of credit increased the demand for law suits.

4. Economic development and the role of the courts: Quantitative analysis

In this section we explore the relationship between the role of the courts and economic development through regression analyses of prefecture-level panel data. The role of the courts is measured by the per capita number of law suits newly accepted by ward courts (*SUIT*). By this variable, we intend to capture how frequently a person relied on the legal services provided by the court. The data points selected are 1895, 1900, 1905, 1910, 1915, 1920 and 1925. That is, we constructed 47 prefectures* 7 year=329 prefecture-year panel data.

Economic development is measured by three variables. The first one is the per capita number of bank bills which we used in the previous section (BILL). In addition to

this, we use the per capita amount of loans by private banks (LOAN). Whereas BILL is a flow variable, LOAN is the stock variable at the end of each year. The source of LOAN is the same as BILL. Both BILL and LOAN are proxies for financial development. The third variable is per capita number of factory workers (FACTORY). The Ministry of Agriculture and Commerce has collected the data on the number of workers employed by factories with no less than 10 employees since the late nineteenth century. From the ratio of factory workers to total population, we are able to measure the extent of industrialization. The data for 1895, 1900, 1905, 1910 and 1915 are taken from various issues of the *Statistics on Agriculture and Commerce (Noshomu Tokeihyo)*, and the data for 1920 and 1925 are taken from the *Statistics on Factories (Kojo Tokeigyō)*. It should be noted that as the data of 1895 and 1920 are not available, we substitute the data of 1896 and 1919 for them, respectively⁸.

We regress SUIT on each of these economic development variables as well as year dummies. The results are reported in Table 4. It is confirmed that the coefficients of the economic development variables are positive and statistically significant, which implies that the people in developed areas tended to rely on law suits more frequently. To put it differently, the court played the role of arbitrator in disputes more frequently in developed areas. In addition, it is notable that the year dummies of 1915 and 1925 are significantly positive, whereas the year dummy of 1920 is significantly negative. 1915 is the year immediately following the bottom of the business cycle and 1925 is in the middle of a prolonged depression after the First World War. On the other hand, 1920 is just after the boom that occurred during the War (Figure 2, Panel B). These coefficients of the year dummies suggest that the number of law suits negatively correlated with the business cycle with a one-year lag, which is consistent with the observations in Figure 2.

We can interpret the positive coefficients of BILL, LOAN and FACTORY as indicating that the scale of economic activity captured by these variables had a positive impact on dispute frequency, and thereby on the frequency of law suits. But it is possible that while economic activity increased the potential for disputes, they did not happen in actuality because they could be resolved or suppressed by other means, for example, by the role of a certain community (Greif 2006). Concerning prewar Japan, it is known that traditional local communities were active and played various roles in certain rural areas. If this is the case, the impact of the scale of economic activity on frequency of law suits is conditional on the function of local communities. In order to examine this hypothesis, we add the interaction term between the economic development variables

⁸ In this case, the population as the denominator is also the data for 1896 and 1919.

and a variable indicating the weakness of local communities, as well as the latter variable itself. The variable is the ratio of urban population to total population in each prefecture (URBAN). Urban population is defined as the population of a city, a town or a village population of which was not less than 50,000. The data on urban population are taken from various issues of the Japanese Imperial Statistical Handbook. The expected sign of the interaction term is positive, because as urbanization progressed this weakened the function of local communities, which in turn would lead to potential disputes actualizing as law suits.

The estimation results are reported in Table 5. The coefficients of the interaction terms are positive in all of the equations, and statistically significant for BILL*URBAN and FACTORY*URBAN. Furthermore, it is notable that in all cases, the coefficients of economic development variables are not statistically significant, unlike those in Table 4. This implies that economic development had a positive impact on the number of law suits only where it was accompanied by urbanization, which supports our conjecture that economic development increased the potential for disputes and that these disputes developed law suits as local communities declined.

As economic development and urbanization progressed, law suits increased, as described in the previous section (Figure 1). An increase in the number of law suits, in turn, led to an increase in the supply of services that support law suits. Figure 4 indicates the change in the number of lawyers over time. It went up steadily from the late nineteenth century to the 1910s, and sharply in the early 1920s. In 1929, there were 6,409 lawyers in Japan, which was 5.15 times more than in 1890. This increase in the number of lawyers indicates the expanded capacity of the legal system to arbitrate disputes, and this expansion supported financial development.

In order to test this hypothesis, we regress the financial development variables (BILL, LOAN) on the lagged per capita number of lawyers and other control variables using the prefecture-level panel data from 1905 to 1925. We control for industrialization (FACTORY) and year dummies. Equation (1) and (3) in Panel A of Table 6 report the results of the baseline OLS regressions. As expected, the coefficient of LAWYER_{t-1} is positive and statistically significant after controlling for the extent of industrialization and macro shocks. In equation (5) and (7) in Panel B of Table 6, we estimate the same equations using a fixed-effect model to control for unobservable prefecture specific variables. In this case, the results are qualitatively the same.

In analyzing the frequency of law suits above, we assumed that the importance of the court depended upon the function of local communities. This relationship should be taken into account. That is, the effect of the number of lawyers on financial

development would be conditional on urbanization. In order to incorporate this effect, we added $LAWYER_{t-1} * URBAN_{t-1}$ as well as $URBAN_{t-1}$. In the case of pooled OLS, the coefficients of $LAWYER_{t-1} * URBAN_{t-1}$ are not statistically significant and the coefficient of $LAWYER_{t-1}$ does not change qualitatively (equation (2) and (4) in Panel A of Table 6). On the other hand, where the fixed effect model is used, the coefficients of $LAWYER_{t-1} * URBAN_{t-1}$ are positive and statistically significant, as expected, and at the same time the coefficient of $LAWYER_{t-1}$ becomes statistically insignificant (equation (6) and (8) in Panel B of Table 6). The results of fixed effect regressions imply that legal institutions supported financial development, and that the importance of this function was conditional on the function of local communities.

5. Concluding remarks

Since the late nineteenth century, the Japanese brought many cases before the courts. Most of these cases dealt with monetary issues. This implies that the court played a substantial role in arbitrating disputes related to economic transactions. Through regression analyses of prefecture-level panel data, it was found that frequency of law suits was positively correlated with the scale of economic activity, and that this relationship was conditional on the function of local communities. That is, economic development had a positive impact on the number of law suits only in the case where economic development was accompanied by urbanization or a decline in local communities. At the same time, it was found that an increase in the capacity of the legal system enhanced financial development. In this case also, the importance the legal system was conditional on the function of local communities.

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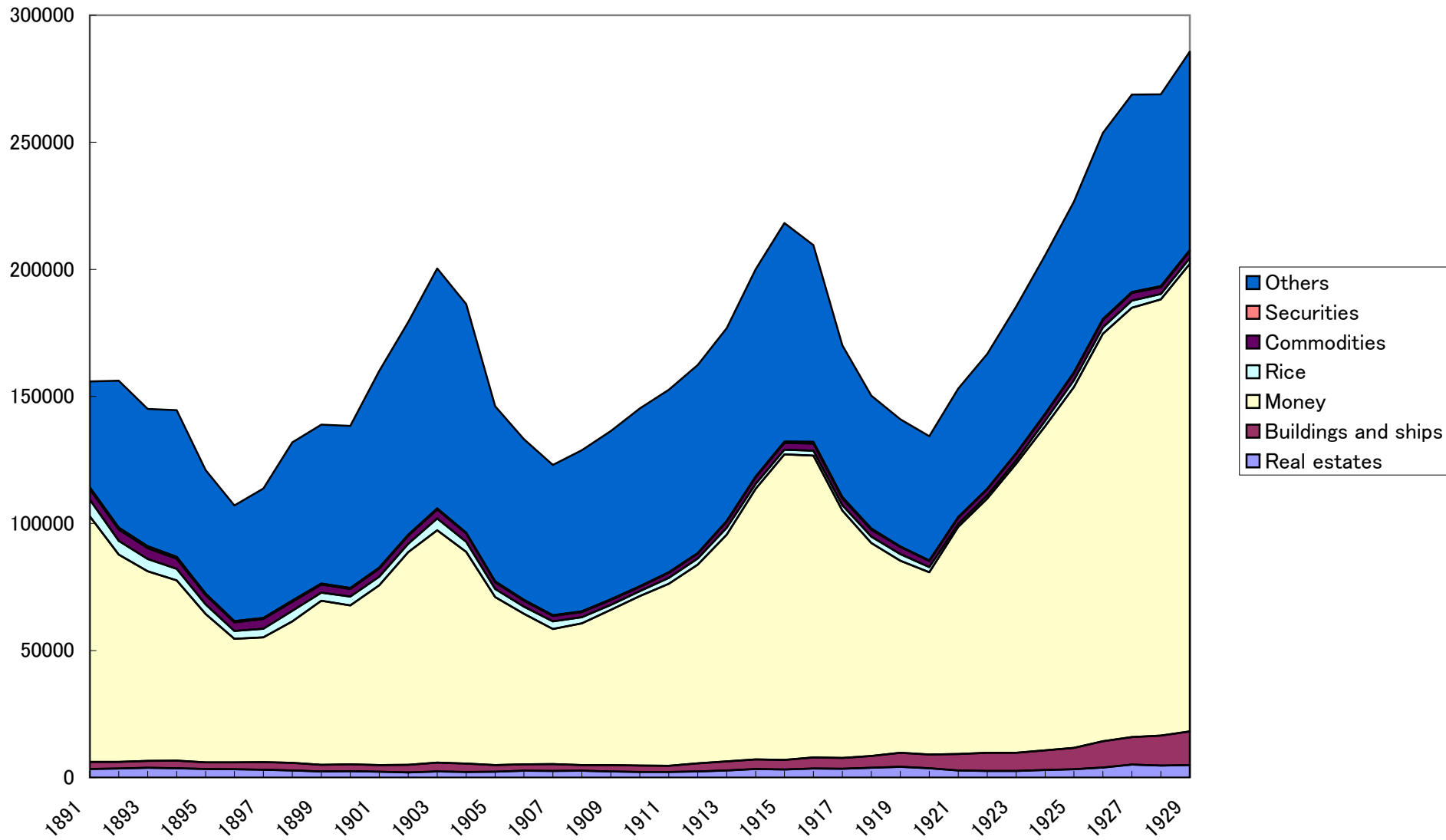
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Table 1 Basic features of the Japanese court system

		1895	1905	1915	1925
Number of courts	Total	358	367	242	399
	Supreme Court	1	1	1	1
	High Courts	7	7	7	7
	District Courts	49	49	50	51
	Ward Courts	301	310	184	340
Number of newly accepted cases: (civil litigation, first trial)	Total	136,087	164,307	246,060	288,909
	District Courts	15,941	20,332	23,402	51,178
	Ward Courts	120,146	143,975	222,658	237,731

Source: Statistical Yearbook of the Japan Empire, various issues.

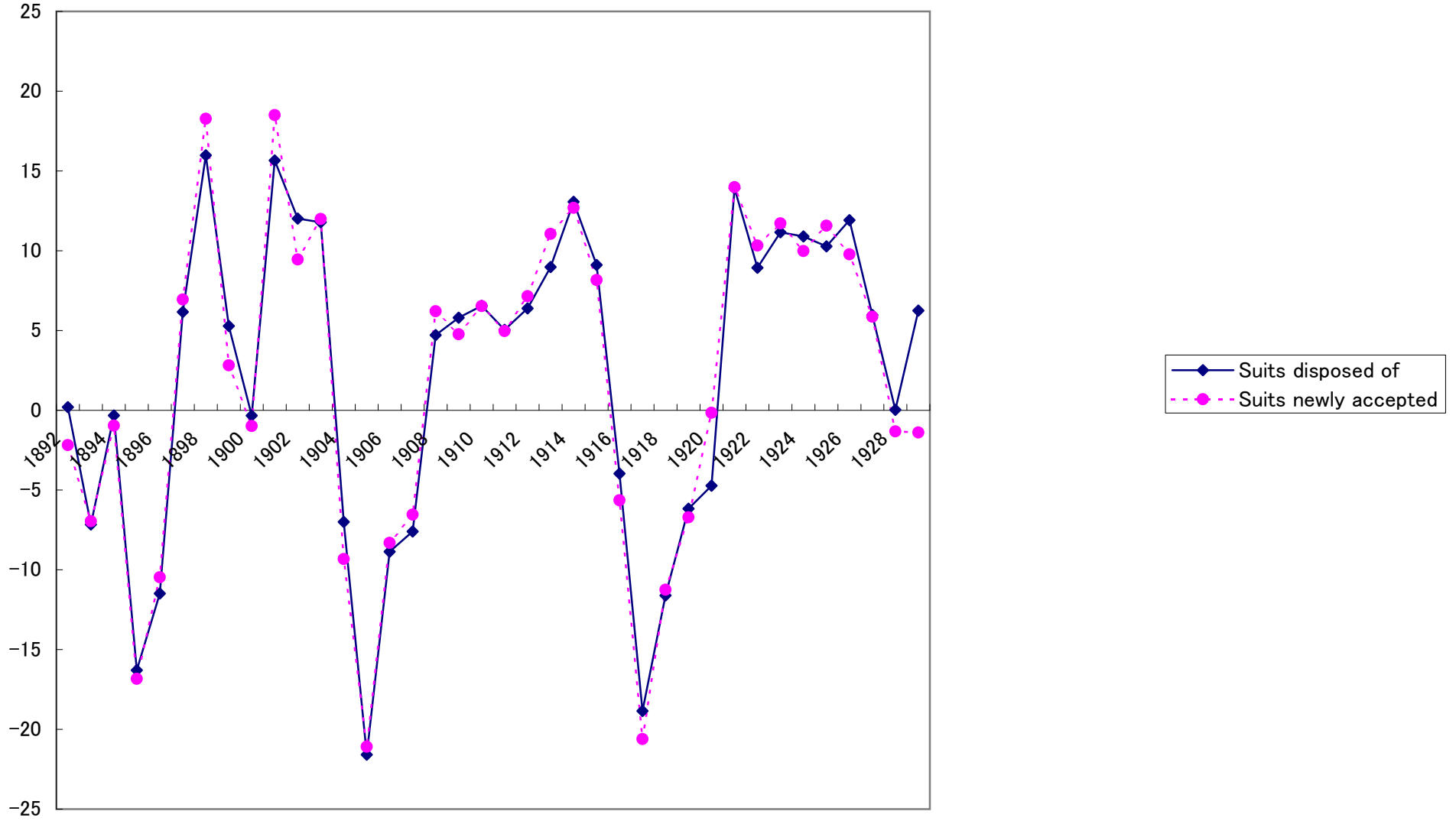
Figure 1 Number of cases disposed at ward courts by issue



%

Figure 2

a. Percentage change in the number of law suits



b. Diffusion index

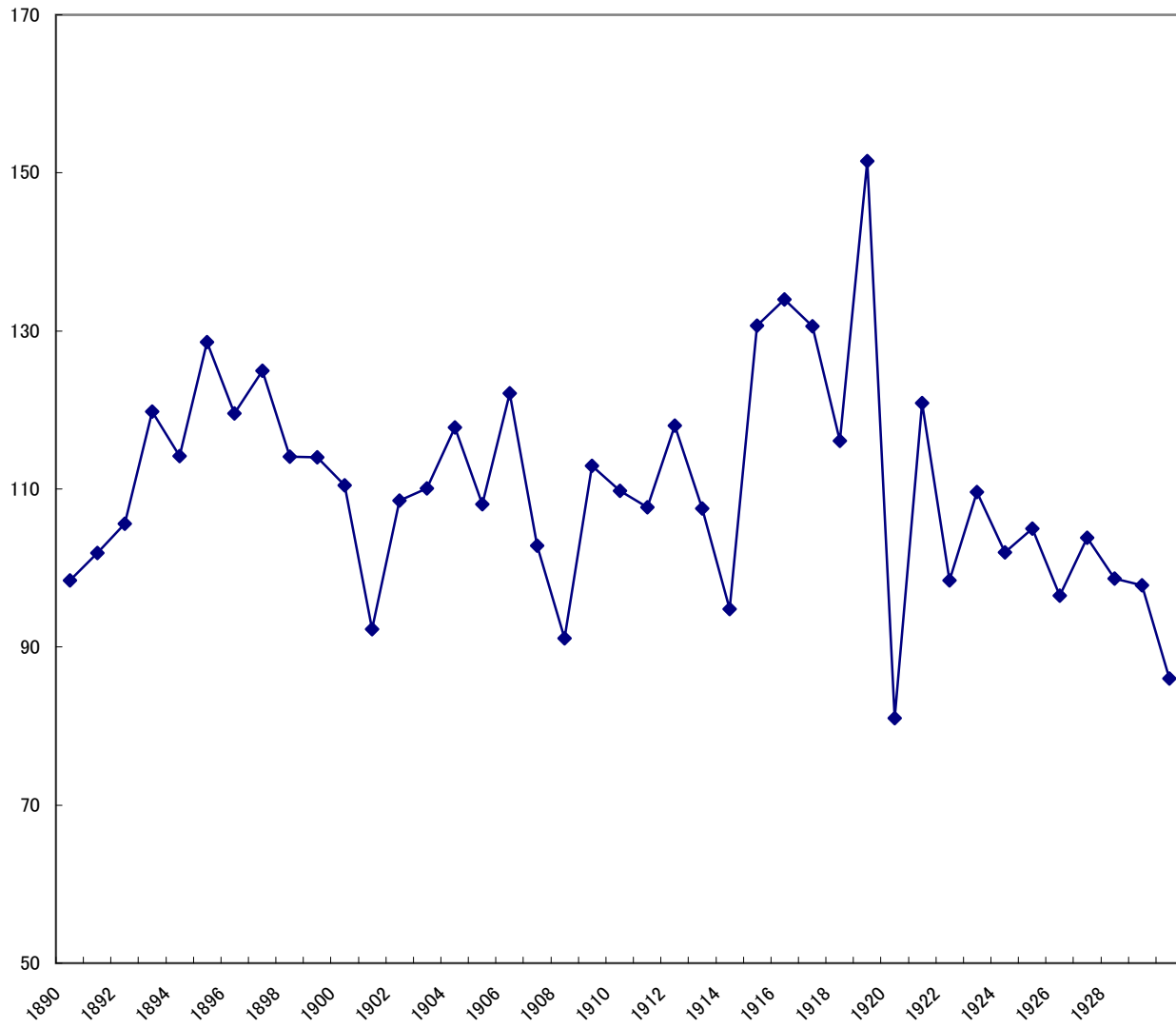


Table 2 Major subcategories of monetary issues disposed at ward courts

1895		1925	
Issues	Number of cases	Issues	Number of cases
Loans without collaterals	29,919	Loans	54,526
Sales prices	4,948	Sales credits	29,799
Loans with real estates as collateral:	3,339	Bills	16,993
Deposits	3,335	Sales prices	5,157
Damages	2,102	Reserve funds	4,607
Reserve funds	1,455	House rents	3,928
Advances	1,236	Damages	3,410
Contracted payments	1,194	Amusement expenses	2,872
Reparations	1,123	Deposits	1,770
House rents	1,069	Maney paid in stocks	1,762
		Guaranteed debts	1,704
		Advances	1,645
		Wages	1,333
		Rents	1,160
Others	71,295	Others	96,011
Total	121,015	Total	226,677

Notes: Subcategories which had more than 1000 cases.

Source: Statistical Yearbook of Civil Litigation, 1895 and 1925 issues.

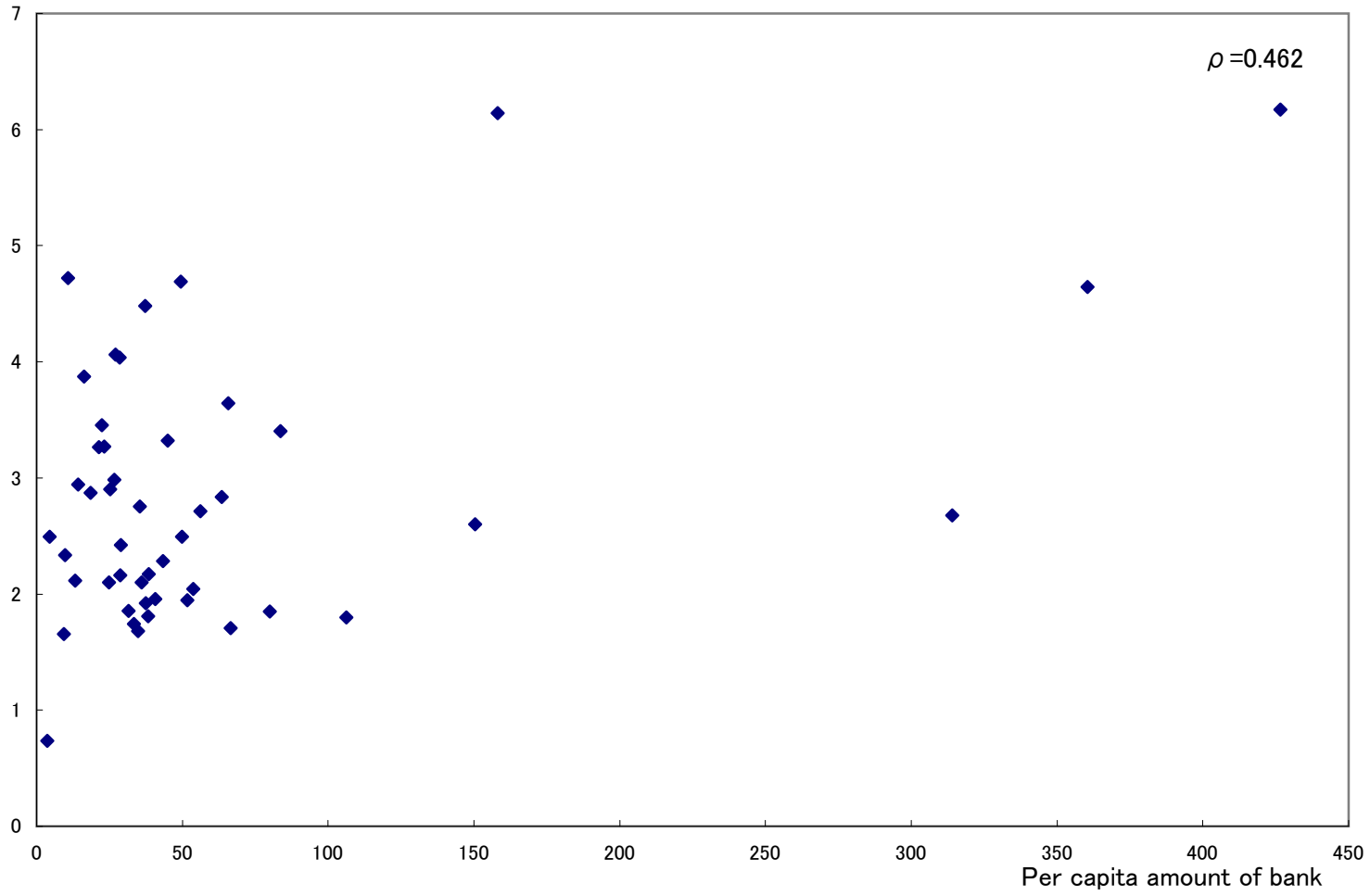
Table 3 Regional distribution of law suits

		1895	1905	1915	1925
Number of suits newly accepted	Total	120,146	143,975	222,391	237,025
	Hokkaido	3,453	5,574	9,250	13,823
	Tohoku	16,690	20,225	22,356	19,759
	Kanto	21,981	25,469	33,723	35,668
	Tokyo	7,715	7,456	14,683	18,997
	Chubu	19,871	28,870	34,746	34,142
	Kinki	21,894	21,552	45,434	46,940
	Osaka	8,315	5,687	17,342	19,235
	Chugoku	10,236	14,786	29,505	28,688
	Shikoku	7,807	7,239	13,585	13,907
	Kyushu	18,214	20,260	33,792	44,098
Per 1000 persons	Total	2.85	3.01	4.09	3.97
	Hokkaido	6.14	5.04	5.13	5.53
	Tohoku	3.60	3.88	3.88	3.21
	Kanto	2.99	2.84	3.33	2.90
	Tokyo	4.64	3.06	5.13	4.24
	Chubu	2.17	2.96	3.19	3.02
	Kinki	3.30	2.85	5.15	4.67
	Osaka	6.17	3.22	7.63	6.29
	Chugoku	2.28	3.08	5.64	5.58
	Shikoku	2.70	2.38	4.08	4.38
	Kyushu	2.80	2.73	3.99	4.86

Figure3 Correlation between financial development and number of

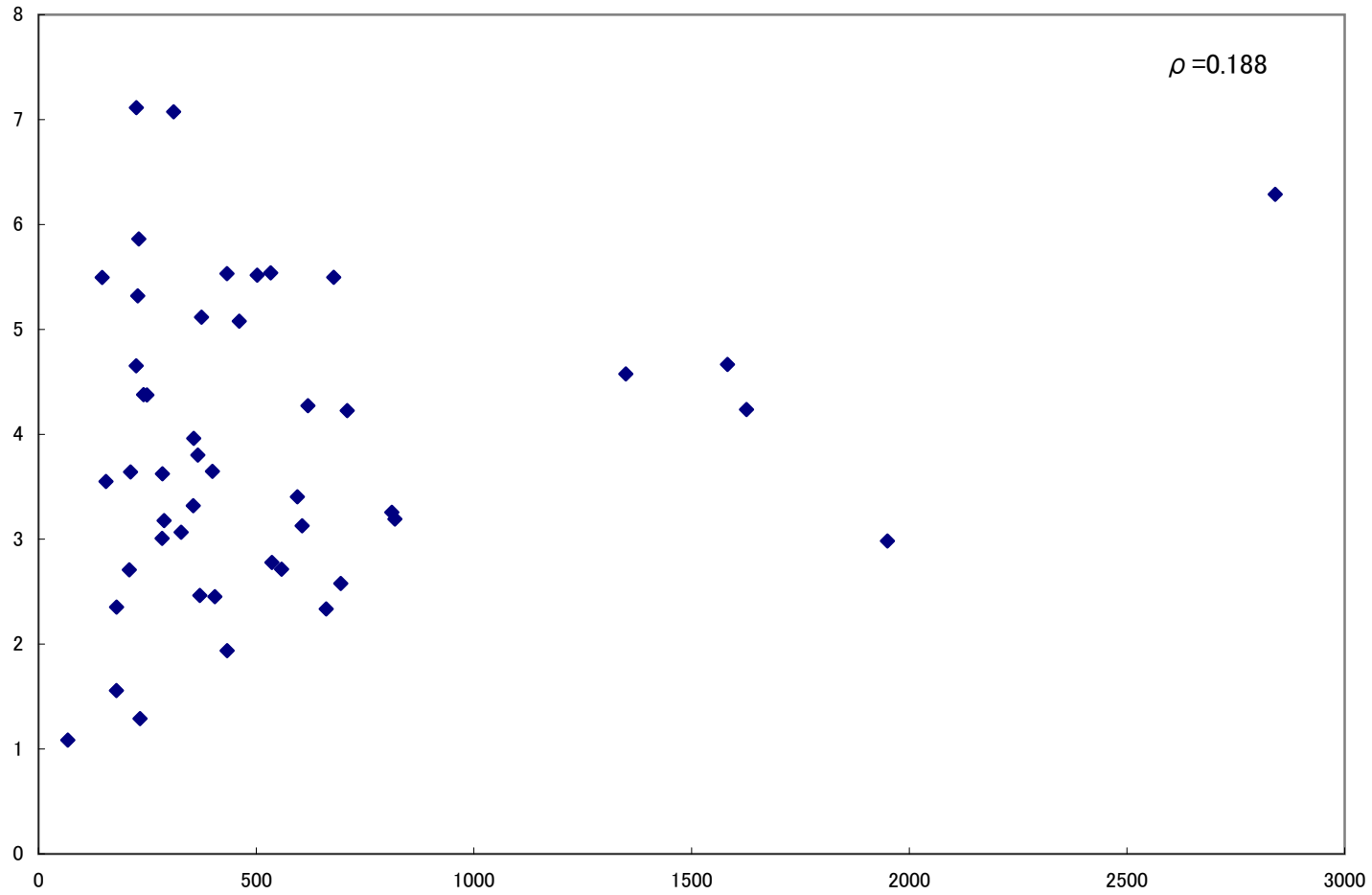
Number of law suits per 1,000

a. 1895



Number of law suits per 1,000

b. 1925



Per capita amount of bank bills (1934-36)

Table 4 Economic development and demand for suits

Dependent variable: SUIT					
BILL	0.0673	(3.52) ***			
LOAN			0.5120	(2.76) ***	
FACTORY					0.0136 (2.27) **
1900	0.0020	(0.84)	0.0002	(0.84)	0.0003 (1.08)
1905	0.0013	(0.60)	0.0002	(0.71)	0.0002 (0.79)
1910	-0.0005	(-0.24)	0.0000	(-0.12)	0.0000 (-0.05)
1915	0.0010	(3.87) ***	0.0010	(3.86) ***	0.0011 (4.05) ***
1920	-0.0008	(-3.61) ***	-0.0007	(-3.32) ***	-0.0007 (-3.11) ***
1925	0.0007	(2.32) **	0.0070	(2.30) **	0.0009 (3.04) ***
Constant	0.0028	(17.07) ***	0.0028	(16.97) ***	0.0027 (16.00) ***
R ²	0.209		0.195		0.196
Obs.	329		329		329

Note: Heteroskedasticity robust t-values are in parentheses.

*** statistically significant at 1% level

** statistically significant at 5% level

Table 5 Economic development, urbanization and demand for suits

Dependent variable: SUIT					
BILL	-0.4488	(-1.03)			
LOAN			-0.4526	(-0.89)	
FACTORY					-0.004 (-0.64)
URBAN	0.0005	(0.88)	0.0009	(1.55)	0.000 (0.06)
BILL*URBAN	0.1655	(2.32) **			
LOAN*URBAN			1.2440	(1.47)	
FACTORY*URBAN					0.052 (2.67) ***
1900	0.0002	(1.02)	0.0003	(1.11)	0.000 (0.98)
1905	0.0002	(0.82)	0.0002	(0.91)	0.000 (0.75)
1910	0.0000	(0.10)	0.0001	(0.24)	0.000 (0.03)
1915	0.0011	(4.08) ***	0.0011	(4.09) ***	0.001 (4.08) ***
1920	-0.0005	(-1.88) *	-0.0004	(-1.70) *	-0.001 (-2.91) ***
1925	0.0010	(3.03) ***	0.0011	(2.93) ***	0.001 (3.27) ***
Constant	0.0028	(17.43) ***		(17.18) ***	0.003 (16.26) ***
R ²	0.225		0.219		0.227
Obs.	329		329		329

Note: Heteroskedasticity robust t-values are in parentheses.

*** statistically significant at 1% level

** statistically significant at 5% level

Figure 4 Number of lawyers

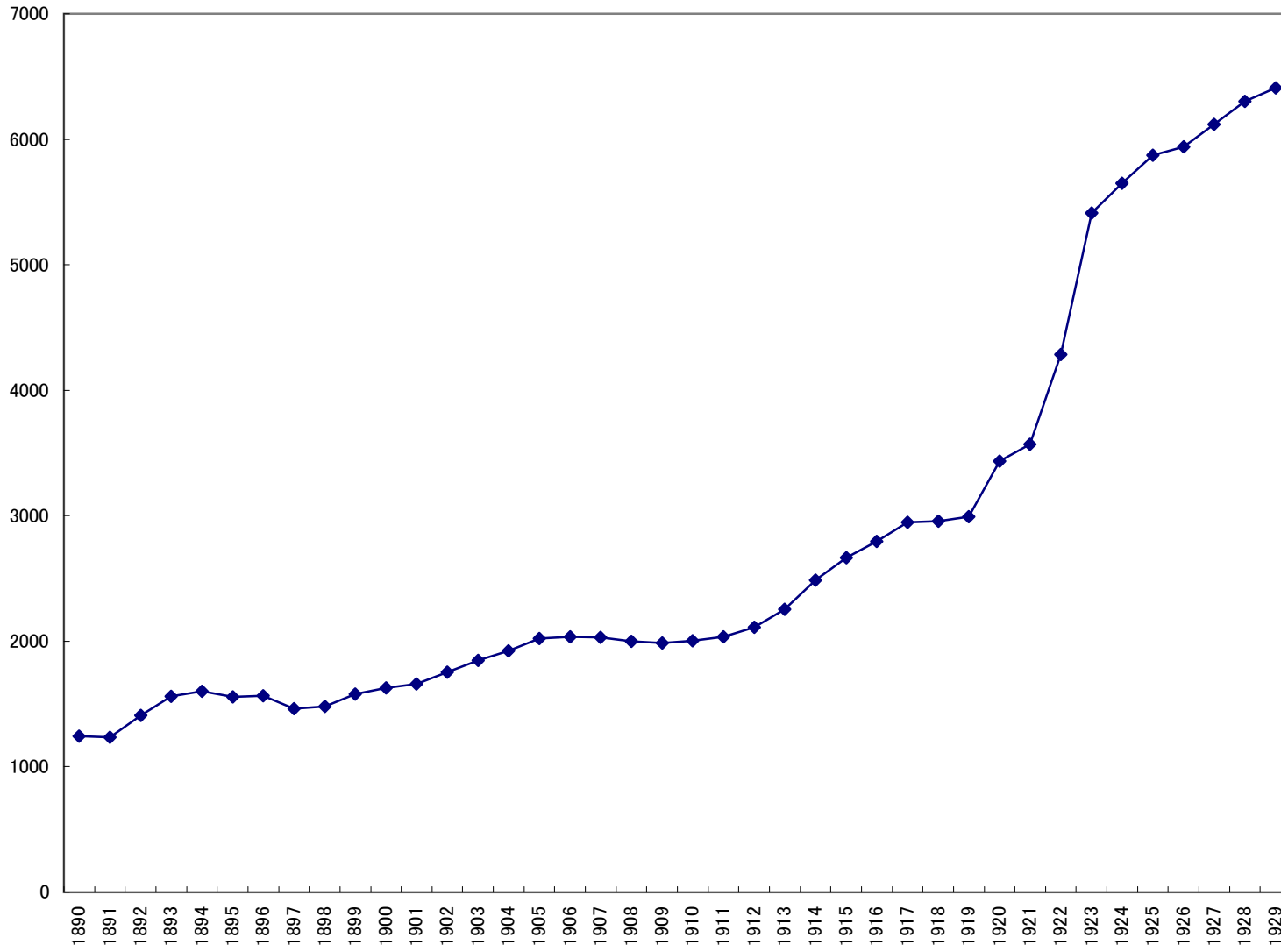


Table 6 Legal institution and financial development

a. Estimates by pooled OLS

Dependent variable	(1)		(2)		(3)		(4)	
	BILL		BILL		LOAN		LOAN	
LAWYER _{t-1}	28.8312	(4.71) ***	16.1262	(1.71) *	4.8699	(6.63) ***	3.4418	(2.63) ***
FACTORY _{t-1}	0.1913	(5.89) ***	0.1480	(5.79) ***	0.0126	(4.96) ***	0.1349	(5.77) ***
URBAN _{t-1}			0.0128	(6.63) ***			-0.0003	(-1.17)
LAWYER _{t-1} *URBAN _{t-1}			-25.7562	(-1.45)			2.8249	(1.13)
1905	0.0005	(1.85) *	0.0004	(1.47)	0.0000	(0.65)	0.0000	(0.71)
1910	0.0002	(0.67)	0.0001	(0.40)	0.0000	(-0.03)	0.0000	(0.19)
1915	0.0004	(0.99)	0.0002	(0.83)	0.0001	(1.75) *	0.0001	(1.78) *
1920	0.0028	(5.76) ***	0.0027	(6.59) ***	0.0003	(6.93) ***	0.0003	(7.09) ***
1925	0.0016	(3.17) ***	0.0018	(4.64) ***	0.0003	(8.01) ***	0.0003	(8.19) ***
Constant	-0.0014	(-3.85) ***		(-3.22) ***	-0.0001	(-3.55) ***	-0.0001	(-1.79) *
R ²	0.693		0.792		0.777		0.781	
Obs.	282		282		282		282	

Note: Heteroskedasticity robust t-values are in parentheses.

*** statistically significant at 1% level

** statistically significant at 5% level

* statistically significant at 10% level

b. Estimates by fixed effect model

Dependent variable	(5)		(6)		(7)		(8)	
	BILL		BILL		LOAN		LOAN	
LAWYER _{t-1}	16.9170	(1.92) *	-5.2413	(-0.46)	7.8286	(7.46) ***	-1.2243	(-1.01)
FACTORY _{t-1}	0.1646	(4.80) ***	0.1491	(4.36) ***	0.0143	(4.42) ***	0.0139	(4.32) ***
URBAN _{t-1}			0.0104	(2.44) **			-0.0007	(-1.61)
LAWYER _{t-1} *URBAN _{t-1}			79.8405	(2.99) ***			21.9788	(6.48) ***
1905	0.0005	(1.70) *	0.0004	(1.54)	0.0000	(0.94)	0.0000	(0.82)
1910	0.0003	(1.17)	0.0001	(0.62)	0.0000	(-0.56)	0.0000	(0.62)
1915	0.0005	(1.65)	0.0002	(1.03)	0.0000	(1.82) *	0.0001	(2.51) **
1920	0.0030	(7.93) ***	0.0025	(8.43) ***	0.0003	(7.03) ***	0.0003	(9.70) ***
1925	0.0020	(4.80) ***	0.0016	(4.06) ***	0.0003	(6.65) ***	0.0003	(7.34) ***
Constant	-0.0008	(-1.81) *	-0.001	(-2.15) ***	-0.0002	(-4.98) ***	-0.0002	(-0.48)
R ²	0.679		0.685		0.750		0.640	
Obs.	282		282		282		282	

Note: Heteroskedasticity robust t-values are in parentheses.

*** statistically significant at 1% level

** statistically significant at 5% level

* statistically significant at 10% level