Transplant Delirium: A Multi-Layered Approach to Studying Domestic Legal Reform Inspired by External Models, Using Afghanistan's *Law of Banking* as a Case Study.

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ABSTRACT

This thesis argues that the state of academic discussions about legal transplantation, i.e. the act of 'borrowing' law from foreign jurisdictions, is currently fragmented and lacks cohesion due to its general inability to account for the topic's inherent complexity and its tremendous empirical variability. Legal scholars concur to a limited extent that the cause of this disarray has something to do with the challenge of theorizing law's complex relationship with society, yet the study of legal transplants lacks any overarching approach that can tackle that complexity in a general way that is still relevant for explanations of how and why law may or may not change in particular cases. This thesis aims to fill this gap by offering a novel multi-layered methodological approach based on 'systems' theories, taken from the natural and social sciences, that is designed to overcome or sidestep many of the theoretical challenges that presently divide and splinter much of the academic discourse. It does so, however, without aiming to resolve most of the core theoretical disagreements among scholars within the field. Rather, it is a 'big-tent' approach, designed to create a space within which such disagreements can continue while creating and preserving some overall coherence that currently is absent. The utility of this new methodological approach is demonstrated in a case study of the evolution of banking in Afghanistan after the promulgation of the 2003 *Law of Banking*. The case study will reveal the ability of the methodology to offer new explanations for why legal 'systems' change as a result of domestic legal reform inspired by external models, as well a means of accounting for the complexity and variability of such change processes.

RÉSUMÉ

Cette thèse soutient que l'étude de la transplantation juridique, l'acte de l'emprunt de droit de juridictions étrangères, souffre de la fragmentation et l'absence de cohésion a cause de son incapacité à rendre compte de manière cohérente la complexité et la variabilité qui est inhérente à lui. Les juristes s'accordent au moins que la cause de ce désordre est le défi de théoriser la relation complexe de droit avec la société, mais l'étude de la transplantation juridique manque une approche globale qui peut surmonter cette complexité, sans perdre sa pertinence pour des grandes études générales, ou des études de cas spécifiques. Afin de remplir cette lacune, cette thèse propose une nouvelle approche méthodologique multidimensionnelle fondée sur les théories dérivés des sciences naturelles et sociales qui peuvent surmonter ou contourner les nombreux défis théoriques profondes qui, au courant, divisent le discours académique. Elle le fait sans chercher à résoudre la plupart des désaccords théoriques fondamentales entre les chercheurs dans le domaine. Il s'agit plutôt d'une approche «grande-tente», conçu pour créer un espace dans lequel ces désaccords peuvent persister, tout en conservant une cohérence pour la discussion académique qui est actuellement absent. L'utilité de cette nouvelle approche méthodologique se révèle dans une étude de cas de l'évolution du secteur bancaire en Afghanistan après la promulgation de la loi bancaire en 2003. Cette étude de cas démontre la capacité de la méthodologie à proposer de nouvelles explications pour comment et pourquoi le changement des systèmes de justice à la suite d'une réforme juridique interne inspiré par les modèles externes, est un moyen de rendre compte de la complexité et de la variabilité de telle processus de changement.

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The kernel of the idea for this paper emerged from a fortuitous error on my part committed in Professor René Provost's class on ‘Legal Traditions’ at McGill University. A mistaken writing assignment led me to a serendipitous encounter with complexity for the first time. This later bore fruit on a long flight to Dubai when the idea of combining complex systems with legal transplant theory hit me and never really let go. In that sense, he is at least indirectly responsible for all this. More directly responsible for helping me work through and finish it was my supervisor Professor Rosalie Jukier, whom I must thank for being so very accommodating to the endless turns and twists that this journey has taken me on. I am most especially thankful to her, though, for her diligent support, her words of wisdom, her encouragement to me to let my strange ideas evolve, and for her unceasing affability in the face of adversity this past year. I feel very fortunate that we were matched together in 2012. Further thanks go to my parents and my brother David, without whose help I would not have kept myself fed or properly housed for the duration of writing this, as well as to Wade Channell, James Filipi and Katie Blanchette for their insights into law and development practices in Afghanistan. Finally, I must thank Dan Pimlott who took a risk by hiring a young Canadian lawyer and flying him to Afghanistan to work on a banking project in 2011, as well as Janet Geddes and John Francies for introducing me to the wild world of bank failures over the dinner table in Kabul.

INTRODUCTION

At the time of writing, a page on the website of the World Bank summarizes the Bank's position on legal transplantation[1] in a rather unusual way. It says:

> New laws are often inspired by foreign experiences. Despite widespread academic debates whether legal transplants are possible at all, they are common practice. However, the degree to which new laws are inspired by foreign examples can vary. A frequent and oftentimes justified criticism is that imported laws are not suited for a certain local context.[2]

It is unusual because it seems paradoxical. While describing legal transplantation as a common tool for legal reform, it also hints at confusion and disagreement about what it is or how it works. It is an accurate reflection of the current state of both its study and practice, however. At first blush, the idea of transferring or copying law from one jurisdiction to another might seem relatively straightforward and technical, with whatever paradox or confusion that may exist seeming unwarranted. Yet, in spite of a wealth of literature that has emerged over the past fifty years, the study of legal transplants is anything but straightforward, and the current academic discourse about it is highly fragmented and lacking cohesion. Efforts to provide general, universal theories of how legal transplant processes do or should work are regularly confounded by the prodigious empirical variability that legal transplant processes around the world actually generate. Such attempts at theory regularly flounder in the face of the evident complexity of law's intricate relationship with society in its multiple and manifold manifestations around the world. Indeed, that complexity and variability have proven to be so great that much current scholarship avoids making comprehensive claims about legal transplantation at all. Instead, most contemporary transplant studies prefer undertaking the more manageable tasks of tackling individual theoretical concepts or specific empirical case

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1 Alan Watson, *Legal Transplants : an Approach to Comparative Law* (Athens: University of Georgia Press, 1993) at 7. A "legal transplant" is a term first coined first by Alan Watson in the 1970s to describe the act of "borrowing" laws from other legal systems or jurisdictions.

2 The World Bank, "Legal Transplants and Legal Culture," online: The World Bank <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTLAWJUSTINST/0,,contentMDK:20759640~menuPK:1990216~pagePK:210058~piPK:210062~theSitePK:1974062~isCURL:Y,00.html>.

studies. Yet, taken together, they read like fragments of an unresolved whole, unwieldy and of limited use to practitioners.

The effect of this has been to render scholarly discussions about legal transplants incoherent, confounding anybody who might want to explain how and why legal transplants cause, or do not cause, legal change. Basic questions routinely defy easy answers for any who ask them: What 'is' a legal transplant? How does one 'work'? What is it that makes the idea of copying laws from elsewhere conceptually difficult and poorly understood? In 1995, William Ewald argued that this analytical impasse was due to the prevailing models for legal transplants being simply not sophisticated enough to handle the complex reality they were trying to explain. What transplant theory needed, he declared, was a "future social theory of law" whose content would have to couple ideas from law, economics, politics, philosophy and social studies, and possess "a cautious awareness of the complexity of the relationship between law and society."[3] To date, no such theory has emerged.

The purpose of this thesis is to offer a methodological approach that will at least encapsulate, if not reconcile, many of the divisions that currently fragment the academic discussion about legal transplantation. Rather than a providing a new theory of its own, this approach will overcome many of the subject's inherent complexities through a novel methodological approach, one that can offer some practical utility for those wanting to understand how and why legal transplants and domestic legal reform processes based on external or foreign models unfold the way they do. To do so, however, it will turn to an unconventional source of inspiration, namely 'systems' theories found mostly in the physical, social and biological sciences. For the past seventy years or so, this heterogeneous body of theory has been expressly tackling the very challenges of complexity and variability that continue to stump legal transplant theorists today. It will argue that the basic concepts of 'systems,' as understood from those scientific perspectives, when applied to the study of legal transplants can act as a kind of methodological resin to bind the disparate shards of the academic discourse together into a coherent whole.

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[3] William Ewald, "Comparative Jurisprudence (II): The Logic of Legal Transplants" (1995) 43 Am J Comp Law 489 at 509.

In short, this paper will offer a novel methodological approach for conceptualizing legal transplants that can address and overcome many of its highly contentious theoretical cleavages. Although this would not be the first study to draw inspiration for the study of law from scientific understandings of 'systems',[4] studies of legal reform through transplantation have not done so to date. Chapter 1 will provide an overview to the academic discussions surrounding 'legal transplantation' with an eye to the main cleavages and trends that have characterized the field over the past fifty years. Chapter 2 will introduce 'systems theory' as a possible means of resolving much of the discord surrounding transplantation, but will also draw attention to what implications or consequences would arise from a 'systems' perspective. Chapter 3 will introduce a methodological approach based on the findings of the first two chapters, mindful of the practical and epistemological limitations they highlight. Finally, Chapter 4 will demonstrate the utility of such an approach by applying it to a brief case study of banking law reform in Afghanistan from 2001 onwards. Although this may seem to be an extreme example with which to test this approach, it is also a very fertile canvas upon which to display its benefits as well as the challenges inherent in trying to understand legal transplants as a phenomenon of legal change.

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[4] Consider, for instance J. H. Ruhl's study of environmental regulation: J. B. Ruhl, "Regulation by Adaptive Management - Is it Possible?" (2005) 7 Minn JL Sci Tech 21 at 23.

CHAPTER 1

Legal Transplant Theory – A Fractured Discourse

Introduction

Over the past half-century, efforts to craft a theoretical foundation for legal transplantation have suffered from a surprising difficulty with explaining why legal change happens in any given case. Explanations remain elusive as to how and why domestic legal reform that is inspired by foreign legal models often produces unpredictable legal and social outcomes that differ from their original aspirations or from the model it emulates. This chapter will explore how the academic discourse evolved over the past forty years, showing how the field shifted from early, simplified claims about causal relationships between law and society, to more nuanced and contextual explanations of social, political and economic factors that impact legal change. It will also show how accepting, or conceding to, contextual nuance required acknowledging the complexity of legal transplantation. Doing so in turn requires accepting that consistently accurate modelling and prediction of the effects of legal transplantation is very difficult. This acknowledgement has fragmented the scholarly discussion about legal transplants into a plurality of studies of individual case studies or particular contextual factors affecting transplant processes that together lack an over-arching meta-theory to link them. Before beginning to conceptualize such a meta-theory, however, it is important to first show how and why this current fragmented state of affairs came to be.

Early Legal Transplant Theory: The Problem of the Law-Society Paradigm

In the mid-1970s, Alan Watson pioneered early discussions about legal transplantation. He framed his work around an argument that the act of "borrowing" laws, rules and legal ideas from foreign legal systems was a primary means by which law changed throughout history, and that it was law's relative autonomy from society that

made this possible.[5] Controversially, he claimed that the historical record showed that "transplanting" a law into a foreign jurisdiction was relatively easy, requiring only sufficient technical and scholarly expertise.[6] Watson was suspicious of broad claims that law somehow reflected the 'spirit' or any particular interests of 'society'.[7] Rather, he argued that, "there does not exist a close, inherent, necessary relationship between existing rules of law and the society in which they operate."[8] He then demonstrated that separation with historical examples from Roman and medieval law where laws persisted through time despite being out of step with the best interests of society. He also provided examples of very different societies and legal cultures adopting the same laws from the same sources.[9] He doubted that there was any definite connection between an amorphous notion of 'society' and something particular like law because the former was simply too heterogeneous, composed of individuals and groups with different and conflicting value systems. Although not directly connected, they were clearly correlated somehow, since "when all the rules are taken together they form a pattern in which the various interests of groups and individuals are represented according to their strength in the society."[10] Thus, he argued, while there must be *some* connection between "the needs and desires of society and its legal rules," such a connection for Watson was "impossible to define" because "society" made it simply too variable.[11]

Watson's argument is a limited, negative proof.[12] He used examples drawn from

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5 Alan Watson, "Comparative Law and Legal Change" (1978) 37:2 Camb Law J 313 at 317–318; Alan Watson, *Society and Legal Change* (Edinburgh: Scottish Academic Press, 1977) at 79–80.

6 Watson, supra note 1 at 95. In Watson's own words: "… the transplanting of legal rules is socially easy. Whatever opposition there might be from the bar or legislature, it remains true that legal rules move easily and are accepted into the system without too great difficulty. This is so even when the rules come from a very different kind of system. The truth of the matter seems to be that many legal rules make little impact on individuals, and that very often it is important that there be a rule; but what rule actually is adopted is of restricted significance for general human happiness."

7 Watson regularly cited a number of scholars who made this claim and positioned himself against them: Geoffrey Sawer (law must reflect the needs or demands of society), Montesquieu (laws are unique to particular peoples), Friedrich von Savigny (positive law is a product of the "spirit of the people," the *Volksgeist*), John Phillip Reid (law reflects the values and characteristic traits of a people), Roscoe Pound (jurists use laws to engineer and secure the interests of society), and even Karl Marx (law represents the interests of the ruling class), among others. See Watson, *Society and Legal Change*, supra note 5 at 1–4.

8 *Ibid* at 118.

9 *Ibid* at 4–5, 110.

10 *Ibid* at 8–9.

11 *Ibid* at 136.

12 William Ewald observed that Watson's argument had two faces which he labeled "Weak Watson" (law

history to disprove notions that law was fully determined by social forces, but left open the question of what that relationship was. The most that could be said about the relationship was that it had to be loose. For Watson, law "possesses a life and vitality of its own" that is driven by professional and socially autonomous communities of jurists, who preferred to imitate and appropriate laws and legal ideas from authoritative sources elsewhere rather than create them entirely from scratch.[13] The proper investigation of legal change therefore required a historical study of how the manner in which these professional communities chose how law would develop determined the course of a given legal system through time.[14]

Watson's work is difficult to categorize. Gunther Teubner once wrote that his claim of law's separation from society challenges social and cultural theory, while his argument that history matters more than narratives of socio-economic structural convergence is challenging for comparative scholars.[15] William Ewald described Watson's work as both "destructive and constructive" by allowing for a nuanced position that "the relationship between law and society is neither non-existent, nor a simple mirroring, but a subtle and intricate interrelationship that must be studied case-by-case," which created a demand for future social theories of law that "will have to be far more complex than the old theories."[16] Such theories would have to be methodologically precise, based on empirical data, and incorporate historical and comparative components. They would also have to grapple with the difficult questions of law's relationship(s) to society that were "unlikely to be straightforward; indeed, it is reasonable to expect that the causal relations between law and society will prove to be reciprocal, interactive, and multi-layered."[17]

Watson's work has received considerable criticism over the years, with its most

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at most is sometimes a mirror of society because there are demonstrable instances in history of its separation from it) and "Strong Watson" (law never mirrors society and is entirely autonomous). Ewald argued that the more cautious "weak" argument was "a major theoretical advance" while the latter was "reckless," "hopelessly antique" and "bankrupt." The author agrees and for the purposes of this thesis has characterized Watson's argument in the former "weak" sense. Ewald, *supra* note 3 at 491–492.

13 Watson, "Comparative Law and Legal Change," *supra* note 5 at 314–315.

14 Watson, *Society and Legal* Change, supra note 5 at 5; Watson, "Comparative Law and Legal Change," *supra* note 5 at 316.

15 Gunther Teubner, "Legal Irritants: Good Faith in British Law or How Unifying Law Ends up in New Divergences" (1998) 61 Mod Law Rev 11 at 15.

16 Ewald, *supra* note 3 at 508–509.

17 *Ibid* at 509.

spirited and controversial attack coming from Pierre Legrand, who argued that legal transplants were "impossible."[18] Legrand argued that because law is a product of society and culture, and interpreting law a socially and culturally-determined process, then any transplanted legal rule will necessarily be interpreted differently and uniquely by a receiving society or culture. While rules might travel, ideological-interpretive practices do not because they are fundamentally cultural expressions. Thus, contrary to Watson, Legrand claimed that law was not autonomous from society at all, but rather was completely determined by it. Indeed, for Legrand, law was so culturally determined that the meaning of any legal rule could only be understood within its cultural context, and that, "[a] rule does not have any empirical existence that can be significantly detached from the world of meanings that characterizes a legal culture."[19] When rules are transplanted, they are deprived of their original social and contextual meaning, leaving them "largely ephemeral," "inevitably contingent," "brittle" and empty.[20] For Legrand, transplantation, therefore, "does not, in effect, happen… the rule that was 'there', in effect, is not itself displaced over 'here'… Meaning simply does not lend itself to transplantation."[21]

Like Watson, Legrand's claim is a negative proof. What he denies is the "possibility" of complete and unadulterated transfers of rules from one legal system, culture or society to another. His approach does allow for the possibility of laws and rules being transferred, borrowed, or shared, but only with inevitable alteration and change upon arrival. This alone is not overly controversial.[22] However, his position is made extreme by three additional propositions that he draws from this: first, that transplantation is an

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18 Pierre Legrand, "The Impossibility of 'Legal Transplants'" (1997) 4 Maastricht J Eur Comp Law 111. Although Legrand is generally credited with, or at least predominantly cited for, this "impossible" claim, his argument is reminiscent of those made by critics of the "Law and Development" movement in the 1970s who often argued that it was not possible to transfer law from one state to another in hopes of mimicking patterns of economic development from country to country. Consider, for instance: Robert B Seidman, "Law, Development, and Legislative Drafting in English-Speaking Africa" (1981) 19:1 J Mod Afr Stud 133.

19 Legrand, *supra* note 18 at 116.

20 Pierre Legrand, "European Legal Systems are not Converging" (1996) 45 Int Comp Law Q at 55.

21 Legrand, *supra* note 18 at 118.

22 Indeed, Watson admitted as much in a reply to Legrand, . "At the very least, for [Legrand] a legal rule in one country expressed in exactly the same wording in another is not the same law. Context is everything. I could not agree more. Indeed from early days I have argued that a rule once transplanted is different in its new home." Alan Watson, "Legal Transplants and European Private Law" (2000) 4.4 Electron J Comp Law, online: <<http://www.ejcl.org/ejcl/44/44-2.html>> at 3.

inherently empty exercise;[23] second, that law and its participants are unavoidably and fully determined by culture;[24] and finally, that transplants cannot change law because law is more than just a collection of "bare-propositional-statements… unencumbered by historical, epistemological, or cultural baggage."[25] On the basis of these propositions, Legrand predicts that law's social embeddedness will make any transplants "impossible" and doomed to failure.[26]

The practical application of transplant theory in legal reform processes has become a hallmark concern for theorists for the past fifty years.[27] While Legrand's claim that a "transplant" is a process of legal change that futilely aims to achieve the complete integration of a foreign law into a receiving system has not been widely adopted, his forward-looking attempt to predict transplant outcomes, however, is more common (except for his pessimism of their inevitable failure). As a tool of legal reform, transplantation has a fundamentally practical character for which predictions of outcomes are not only desirable, but also necessary to justify their use. For the remaining authors surveyed below, the central question about law's relationship to social context has very practical implications for transplant outcomes. However, it is precisely because of this

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23 Legrand, *supra* note 18 at 117.

24 *Ibid* at 120; Legrand, *supra* note 20 at 57.

25 Legrand, *supra* note 18 at 113–114, 120.

26 The extremity of Legrand's critique of Watson is rooted in his broader and equally as spirited opposition to legal harmonization projects in Europe. From his perspective for the harmonization of European law to be meaningful would require replacing each of Europe's constituent legal systems with a single set of rules imposed upon each member state, which invariably would be interpreted differently by the historical, cultural and contextual characteristics that make each different. It is European legal harmonization, therefore, that Legrand thinks is truly "impossible." Legrand, *supra* note 20 at 74–78.

27 Legal transplants have been key feature in the "law and development" discourse on the efficacy and ethics of using legal reform as tool for social or economic development. Scott Newton describes four historical phases of this discourse, that has roots in the colonial past, but as an intellectual discourse spans the period from the 1960s to the present day: the "Inaugural Moment" (1965-74) where the United States invested in legal development cooperation projects abroad aiming at modernizing developing countries and their economies; the "Critical Moment" (1974-1989) where the former assistance approach was criticized for its empirical failures, neo-colonial overtures and its lack of attention to domestic context; the "Revivalist Moment" (1989-1998) when the restructuring of the post-communist world saw a return to embracing the idea of law being used as a tool for economic growth and an explosion of technical assistance projects, and finally the "Post-Moment" (1998-present) consisting of an ongoing critical re-evaluation of the experiences of legal development processes since 1989, especially critiques of market fundamentalism dominating development economics. Scott Newton, "Law and Development, Law and Economics and the Fate of Legal Technical Assistance" in Julia Arnscheidt, Benjamin van Rooij & Jan Michiel Otto, eds, *Lawmaking for Development: Explorations into the Theory and Practice of International Legislative Projects* (Leiden: Leiden University Press, 2008) 23 at 25–30.

concern with its practical application, efforts to capture transplantation in theory in ways that can predict outcomes have been constantly frustrated by the inherent complexity and variability of how that relationship manifests itself the world over.

Law in "Context"

Despite its extremity, Legrand's argument is useful in offering some explanation for why the outcomes of legal transplant processes often differ from their original ambitions. Such processes have frequently been observed to fail due to mismatches between a transplanted rule and its receiving environment. James Gardner has written how legal assistance from the United States to Latin America in the 1960s largely failed because lawyers did not understand the local language or social, economic and political contexts. This lack of understanding made such projects "inept, culturally unaware, and sociologically uniformed," and vulnerable to diverse patterns of political, economic and social change.[28] If transplants were to have any hope of having their intended development effect, therefore, planners had to somehow render unproblematic vast differences in culture, wealth, geography, religion, socio-economic and political systems.

Taking such variable contextual factors into account, however, requires moving beyond the Watson-Legrand debate about the connection between law and society. A number of scholars have instead asked how and when "context" determines a transplant's success or failure. Otto Kahn-Freund was an early proponent of the importance of understanding the effect of socio-political context on law and transplant processes.[29] Because such effects were so highly variable from case to case, knowing whether any particular law was inherently "transplantable" or not required understanding the socio-political context into which it was to be transplanted. The viability of a transplant could be determined, he argued, according to its ability to "de-couple" itself from its social roots. Laws in areas that were more intimately connected to a society's socio-political fabric would be more difficult to transplant than those with a weaker connection.[30]

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[28] James Gardner, *Legal Imperialism: American Lawyers and Foreign Aid in Latin America* (Madison, Wis.: University of Wisconsin Press, 1980) at 9, 247.

[29] Otto Kahn-Freund, "On Uses and Misuses of Comparative Law" (1974) 37 Mod Rev 1 at 11–13.

[30] *Ibid* at 7–13. Kahn-Freund argued that it was possible to determine that relationship by analyzing three key factors: a) the general political structure of the state and Government and the similarities between

Kahn-Freund's work inspired that of Gunther Teubner, who has looked for a middle ground between Watson, whose work he feels was too dismissive of the importance of social context, and Legrand, whose espousal of a 'totality of society' he criticizes for being excessively culturally-focused and deterministic.[31] In their place he argues that transplants cause change when an imported law or rule "irritates" a receiving system, provoking the receiving society and legal system to adapt to find appropriate ways to accommodate it. Transplant outcomes are variable and unpredictable because once introduced, 'irritating' transplants "unleash an evolutionary dynamic in which [its] meaning will be reconstructed and the internal context will undergo fundamental change."[32] Where the rule "will be re-contextualized in the new network of legal distinctions," it will also:

> ... create perturbations in the other social system and will trigger there some changes governed by the internal logics of this world of meaning. It will be reconstructed in the different language of the social system involved, reformulated in its codes and programmes, which in turn leads to a new series of events. This social change in its turn will work back as an irritation to the legal side of the institution thus creating a circular co-evolutionary dynamic that comes to a preliminary equilibrium only once both the legal and the social discourse will have evolved relatively stable eigenvalues in their respective spheres.[33]

For Teubner "context" is composed of the "binding arrangements" that tie law to social discourses, which can vary greatly from place to place.[34] Unlike Watson and Legrand, Teubner feels it is not meaningful to speak of a law-society connection in any singular way, since law is instead "a fractured multitude of social systems which allows

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that of the giving and receiving state; b) how power is distributed within that political system, and c) the role played by organized interest groups within it. In practice, however, such an approach is more difficult than it may sound. Steven Heim tested the analytical practicality and predictive capacity of Kahn-Freund's approach and found that it had serious explanatory limitations for laws with no obvious or inherent political dimensions that one could measure. Steven J Heim, "Predicting Legal Transplants: the Case of Servitudes in the Russian Federation" (1996) 6:1 Transnat'l Law & Contemp Probs 187 at 216.

31 Teubner, *supra* note 15 at 14.

32 *Ibid* at 12.

33 *Ibid* at 28.

34 *Ibid*.

accordingly only for discrete linkages with these fragments."[35] Like Kahn-Freund, he claims that this fragmented reality permits one to argue that the impact of 'context' will be variable depending on the importance of what is at stake. Imported legal rules that propose changes to structures that are strongly attached to ongoing social discourses in areas such as politics, economics, technology, health or science will transplant less easily than those that are more technical and separated from those social discourses.

Roger Cotterrell also speaks of transplants having to negotiate a fragmented social reality, but characterizes "context" differently as a dynamic involving struggles between overlapping layers of interacting and competing "communities" and group interests within society. Each "community" layer is distinct and characterized by different forms of social bonds and relationships to law, which will affect a transplanted law through multiple links to "different kinds of need and problems associated with different kinds of social relationships."[36] For Cotterrell, law in practice does not easily attach itself to theoretical abstractions because of these complex relations, which makes generalization difficult since every study will be unique.[37] A consistently accurate, general theory about legal transplants, he argues, is therefore not feasible because it would have to sacrifice all of the detailed, idiosyncratic nuances that makes each society different. Nevertheless, by examining how stakeholders in a society interact with or are affected by a transplanted law, it is possible at least to start to understand how it may change or be changed by them. However, doing so will often be terribly complicated.[38]

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35 *Ibid* at 22.

36 Roger Cotterrell, "Is There a Logic of Legal Transplants?" in David Nelken & Johannes Feest, eds, *Adapting Legal Cultures* (Oxford: Hart Publishing, 2001) 71 at 83, 90.

37 *Ibid* at 83.

38 David Nelken has described why a study based on a multi-layered model of society like that which Cotterrell proposes would be so difficult: "One of the most fruitful questions in the sociological study of changes in legal culture is to ask who and what is inviting, 'receiving' or enduring such changes. Depending on our theoretical starting points we can focus on agents, institutions, networks, sub-systems, legal and social 'fields', communities, professions, committees, structures or discourses. It can also be valuable to distinguish the different roles being played, whether they be those of facilitators, educators, guardians or doctrine, planners, regulators, interpreters, activists, mediators or fixers. The bearers of change can include states, national, international and transnational bodies, non-governmental organizations, corporations, banks and other economic actors, politicians, regulators, foundations and philanthropists, bureaucrats, judges, lawyers, accountants and other professionals, and academics. Legal change can be brought about through immigration… but the role of students returning to their home countries after studying abroad has been of central importance ever since the invention of universities. Influential actors are likely to be members of elite groups or other important political and social networks, but the number of those potentially affected by such change embraces a much wider

Lawrence Friedman provides a further, wider-angle perspective on legal transplants and legal change by arguing that the scope of analysis should encompass broad processes of social change writ large. He argues that the focus on transplanted laws themselves distracts away from more meaningful questions about the social effects of modernization and industrialization on legal change. It is these larger phenomena, rather than new laws, that really "transform society and create new needs and problems for legal solution." Meeting such needs and problems, "countries adapt, beg, borrow, or steal law from places that have faced the problems earlier, or came up with an earlier response."[39] For Friedman, thus, a transplant's success will depend more on its relevance to broader processes of social change, rather than on its content, or on the players or social groups who engage with it.

Pistor, Keinan, Kleinheistercamp and West have undertaken a large-scale comparative empirical study of legal transplants that confirm Friedman's argument to a certain extent. They compared the evolution of corporation laws in both originating and transplant-receiving countries, they found that:

> … corporate law does not evolve in isolation, but in close interaction with socioeconomic conditions and politics, as well as other parts of the legal system. This implies that isolated change of some provisions in corporate law can have at best little impact on the overall direction of the evolution of corporate law.[40]

Their research revealed that when identical features of the same laws were copied and transplanted from one place to several receiving countries, they evolved differently as each legal system responded differently to how the law confronted unique domestic

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number of organised or unorganised ordinary citizens." David Nelken, "Towards a Sociology of Legal Adaptation" in David Nelken & Johannes Feest, eds, *Adapting Legal Cultures* (Oxford: Hart Publishing, 2001) 7 at 24.

[39] Lawrence Friedman, "Some Comments on Cotterrell and Legal Transplants" in David Nelken & Johannes Feest, eds, *Adapting Legal Cultures* (Oxford: Hart Publishing, 2001) 93 at 94–95. Friedman offers a historical thought experiment: could Japan have successfully incorporated/received western legal codes in the 19th and 20th centuries if it had not been undergoing a massive process of modernization at the same time? He argues that regardless of whether or not Japan had taken western laws, that its legal system would have evolved regardless to meet the demands of its modernizing society.

[40] Katharina Pistor, Yoram Keinan, Jan Kleinheistercamp & Mark West, "Evolution of Corporate Law: A Cross-Country Comparison" (2002) 23 U Pa J Intl Econ L 791 at 864.

socio-economic and political circumstances.[41] However, instead of requiring that an imported law 'fit' a local context to be 'transplantable,' their study concluded that transplant processes were only successful when receiving legal systems and societies were 'healthy' enough to adapt them to fit local needs. If a transplanted law or rule remained unchanged in a receiving legal system over time, this was less a sign of a good 'fit' but rather an indication that the receiving system was incapable of altering it effectively to respond to domestic concerns.[42]

Patterns of "Context"

Despite their differences, the authors surveyed above generally agree that deducing explanations of legal transplants from general theories of law and society is difficult to do because social reality is highly complex. A number of other scholars have tried to deconstruct that complexity by asking why actors within it behave the way they do. Rodolfo Sacco, for instance, tackled 'context' by seeing law as an inherently social phenomenon composed of non-static, constituent "formants" that play active, constructive roles within a legal system. These "formants" could be any number of things: statutory rules, doctrine, scholarly opinions, judicial decisions, government policies, etc., all of which are engaged by individuals, groups or institutions that interact with one another.[43] Thus, rather than seeing the law as a "more or less consistent system of interrelated propositions," Sacco understood law as a "battleground of competing sources and professional elites."[44] This competition made it possible for contradictory or countervailing legal formants to coexist within the same system, with the relative importance of any given 'formant' being equal to its ability to influence others therein.[45]

Although rather ambiguous, the concept of 'legal formants' shifts focus towards searching for patterned relationships between factors that determine transplant outcomes. A number of scholars have attempted such studies and a (non-exhaustive) few are

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41 *Ibid* at 865–866.

42 *Ibid* at 870.

43 Rodolfo Sacco, "Legal Formants: A Dynamic Approach to Comparative Law (Installment II of II)" (1991) 39:2 Am J Comp Law 343 at 343.

44 Pier Giuseppe Monateri, "The Weak Law: Contaminations and Legal Cultures" (10) 13 Transnat'l L & Contemp Probs 575 at 582.

45 Rodolfo Sacco, "Legal Formants: A Dynamic Approach to Comparative Law (Installment I of II)" (1991) 39:1 Am J Comp Law 1 at 24, 32–33; Sacco, supra note 43 at 385–386.

highlighted below, presented along the lines of a particular formant-like feature that they argue has a significant effect on transplant processes. Individually, none can capture the entirety of the transplant process, but each provides a glimpse of how heterogeneous the whole might be.

'Prestige' and 'Efficiency'

Sacco argued that all transplant processes could be characterized according to two basic forms of legal imitation: 'imposition' and 'prestige,' the difference being whether the initiative for change came from a powerful transplant-providing country (imposition), or arose instead from a receiving country seeking to emulate another (prestige).[46] Of the two, 'prestige' has historically been the more influential and long-lasting, he argued, because imposition could be undone once the dynamics of power changed.[47] Despite its apparent simplicity, Sacco's approach is sophisticated in offering some explanation for why transplantation might be selected as a legal reform mechanism, and why any particular law might be selected over others.[48]

Other authors have elaborated further on how 'prestige' affects actors engaged in legal reform and transplant processes. Studying the post-communist transition of the early 1990s, Gianmaria Ajani identified a number of pressure factors that directed actors to seek out foreign models for law reform. These factors included: "the need to legislate in a short time and to fill the vacuum left by the previous experience; pressure from supranational organizations as well as of international financial institutions; and also the simple desire of the politicians, and jurists to provide one's system with tools already in use elsewhere."[49] For Ajani, it was possible to explain why certain legal models were promoted and received over others by seeing transplant choices as outcomes of combining 'prestige' with other contextual factors, like the geopolitics of international

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46 Sacco, *supra* note 43 at 398.

47 *Ibid* at 399. According to Sacco, prestige "carried the medieval Roman law across Europe. Prestige carried the French Civil Code and German doctrine beyond the frontiers of the civil law. Prestige made the penetration of French and English rules and institutions into Africa irreversible. The prestige of the Shari'a has eroded numerous African usages."

48 *Ibid* at 400.

49 Gianmaria Ajani, "By Chance and Prestige: Legal Transplants in Russia and Eastern Europe" (1995) 43 Am J Comp Law 93 at 103.

development, "political opportunity," or even "chance."[50] Ajani's study, thus, adopted Sacco's 'formants' approach, but with a 'Watsonian' focus on the prestige-seeking behaviour of legal elites. His approach also appreciates the complex and variable political contexts of domestic legal reform, similar to Cotterrell's complex law and society construct. Ugo Mattei is another author who has written about prestige and transplantation, however he argues that one must be careful to not attribute any inherent prestige quality to legal systems, rules or principles. For Mattei, 'prestige,' is really a derivative feature of the economic considerations of legal actors, who attribute prestige to certain models because they are the most economically efficient. Concerns about 'prestige', thus, mask an underlying discourse about 'efficiency' that is more fundamentally determinative of the dynamics of the international market of legal rules.[51]

Demand for Law

"Prestige" is only one of several attributes that scholars have identified as relevant to explain legal change through transplantation. Some authors have characterized the dynamics of transplant reception in terms of a legal system's "demand for law" instead. Berkowitz, Pistor and Richard, for instance, undertook a broad comparative study that evaluated examples of both transplant-producing and receiving countries according to an index of "legality," that measured the relative "health" of a country's legal system. By quantifying a number of factors such as the "judiciary, rule of law, the absence of corruption, low risk of contract repudiation and low risk of government expropriation," the authors offer an explanation for why some countries developed more effective legal institutions than others using the same rules.[52] They argue that it is the process of lawmaking itself, rather than the origins or content of legal rules, that determine the

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50 *Ibid* at 110–115.

51 Ugo Mattei, "Efficiency in Legal Transplants: An Essay in Comparative Law and Economics" (1994) 14 Int'l Rev Law & Econ 3 at 3–8. Jonathan Miller notes that Mattei's "efficiency" argument is itself limited and idealized, however, because it presumes a free-flow and ubiquitous availability of information about legal rules and practices in the "marketplace". For Miller, the "prestige" of a legal model or rule becomes relevant but also distorted because of the inherent inefficiency of the market itself. Jonathan M Miller, "A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process" (2003) 51 Am J Comp Law 839 at 855.

52 Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, "The Transplant Effect" (2003) 51:1 Am J Comp L 163 at 189.

"health" of a country's legal system and its "demand for law." It is both a system's health and its demand for law that will determine the success that any given legal reform will have. They observed that although transplanting a law from a foreign source requires fewer effective institutions and considerably less effort than creating one from scratch, transplant experiences tend to be less successful than home-grown initiatives.[53] Indeed, they observed that countries that depended on legal transplants for legal reform tended to not have 'healthy' systems and were less likely to successfully implement and adapt a transplanted law to achieve a desired local outcome. It was the 'health' and 'demand' for law of the receiving system that affected how meaningful the law would be to the local context, and how much incentive "judges, lawyers, politicians, and other legal intermediaries that are responsible for developing the law" would have to adapt it to increase its local relevance and quality.[54] When a law is transplanted into an unhealthy or infertile legal environment, it will cease to take hold, a phenomenon that Berkowitz, Pistor and Richards refer to as "the Transplant Effect."[55]

In a broad sense, this argument is prescriptive: legal transplants will succeed if the receiving country is healthy and has a 'demand' for it. It is also, however, somewhat circular since "demand for law" is somehow both a cause and effect of a legal system's health. Nevertheless, it is useful because it offers some explanation for why the content of transplanted laws cannot be relied upon alone to produce desired judicial or other outcomes.[56] Context is key.

Path Dependency and Typologies of Origins

An alternative approach to locating determining factors in transplant processes has been to categorize internal starting conditions in the form of established interest group and institutional structures in place at the time a transplant is introduced. Lucian Bebchuk and Mark Roe's comparative study of path dependency behaviour in corporate structures is one such approach, which demonstrates that regardless of external forces like globalization or efficiency pressures, law will not always adapt or respond to contextual

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53 *Ibid*.
54 *Ibid* at 167.
55 *Ibid* at 171.
56 *Ibid* at 190.

changes after a law's promulgation. The reason they provide is that factors like "sunk adaptive costs, complementarities, network externalities, endowment effects, or multiple optima," as well as the economic and rent-seeking behaviour of influential interest groups will maintain laws and institutions in place, even when they are anathema to the interests of society at large.[57]

In a similar vein, Jonathan Miller has compiled a four-part typology of initial conditions determinative of transplant processes based on different actor motivations and transplant ambitions. This typology consists of: the "Cost-Saving Transplant", the "Externally-Dictated Transplant", the "Entrepreneurial Transplant", and the "Legitimacy-Generating Transplant."[58] Each of these types involves "different sorts of dialogue about legal issues," that set a path determining their respective futures. Thus, a law borrowed in order to save cost and effort (the "cost-saving" transplant)[59] will have a different outcome than one that is received in order to please foreign states (the "externally dictated" transplant).[60] Furthermore, the manner in which domestic legal 'entrepreneurs' seeking prestige, loyalty or financial rewards champion a foreign transplant will also affect transplant outcomes in variable ways.[61] For all the benefit of categorizing transplants in this fashion, however, such a typology has a limited ability to account for why similar originating conditions might produce greatly different outcomes or behaviours in different places. Indeed, Miller cautions against using his typology to predict the future. It can provide "only a limited indication of why some transplants are successful while others are not," and Miller argues that, "most newly enacted laws are successful in achieving the aims of their drafters for domestic reasons unrelated to whether the norm is a legal transplant."[62]

"Palace Wars"

A rather different approach to studying legal transplantation is offered by Yves

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57 Lucian Arye Bebchuk & Mark J Roe, "A Theory of Path Dependence in Corporate Ownership and Governance" (1999) 52:1 Stanford Law Rev 127 at 137–139.
58 Miller, *supra* note 51 at 842–843.
59 *Ibid* at 846.
60 *Ibid* at 849.
61 *Ibid* at 853.
62 *Ibid* at 842–844.

Dezelay and Bryant Garth, who describe it as the rewards-seeking interplay between foreign rule exporters, domestic importers and social capital entrepreneurs. Domestic institutions like the state and local law faculties determine the local dynamics of transplant-driven legal reform, while international geo-politics drives competition among transplant exporters, such as the United States and Europe.[63] Dezelay and Garth argue repeatedly that it is the pursuit of national, ideological or economic "strategies" that determines the behaviour of actors who import and export law. Exporting countries pursue strategies to further geopolitical ambitions, while "cosmopolitan elites" and local power brokers in receiving countries do so to develop domestic networks of influence. The interaction and conflict between these multiple strategies create contests to determine the shape of a country's future legal evolution, which the authors label "Palace Wars". Like Ajani, it unites Cotterrell and Watson by explaining how elite classes of jurists are enmeshed within webs of international and domestic political networks and structures within which legal reform 'strategies' are employed in pursuit of gain.

Globalization

The geopolitical focus of the 'Palace Wars' approach is similar to discussions about how "globalization" is related to legal transplantation. David Gerber argues that the international cross-fertilization of laws is increasing as globalization brings legal cultures into greater direct contact with one another. Such contact "influences what legal professionals want and need to know about foreign law, how they transfer, acquire and process information, and how decisions are made."[64] Others have described globalization as a force that is propelling the internationalization and convergence or harmonization of legal systems around the world.[65] Gunther Teubner argues that globalization has provided the *lex mercatoria* with its current stateless and transportable character by severing whatever cultural roots it may have had in the past.[66] Furthermore, world-wide

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63 Yves Dezalay & Bryant G Garth, *The Internationalization of Palace Wars : Lawyers, Economists, and the Contest to Transform Latin American States* (Chicago: University of Chicago Press, 2002) at 6.

64 David Gerber, "Globalization and Legal Knowledge: Implications for Comparative Law" (2001) 75:4 Tulane Law Rev 949 at 650.

65 Rene de Groot, "European Education in the 21st Century" in Bruno de Witte & Caroline Forder, eds, *The Common Law of Europe and the Future of Legal Education* (Maastricht: Kluwer, 1992) at 54.

66 Gunther Teubner, "'Global Bukowian': Legal Pluralism in the World Society" in Gunther Teubner, ed,

communication networks and constant interaction between legal systems and cultures are creating a "global legal discourse" that is facilitating the international diffusion of law by making it increasingly difficult to clearly distinguish separate legal systems as manifestations of distinct national cultures.[67] Katharina Pistor and Philip Wellons similarly argue that constant interaction in the global market of international investment and trade has whittled away regional differences that once inhibited legal transplantation in the past, thereby clearing the way for greater global harmonization in the future.[68]

Despite its popularity, 'globalization' is better at explaining where transplants come from than what happens to them once they are promulgated somewhere. David Nelken questions the extent to which 'globalization' can capture the entirety of the local setting for transplants, since "[s]imilar legal trends may not necessarily prove that the world is generally becoming more homogenous and alike."[69] It is considerably easier to show how globalization has turned international legal discourse into a singular source for legal transplants. Jonathan Weiner describes a process he calls "vertical borrowing" or "trans-echelon transplantation," whereby international lawyers and diplomats derive legal norms upwards from domestic systems, which are then re-transplanted downwards as internationally-sourced transplants elsewhere. This he distinguishes from "horizontal" borrowing or "transnational" transplantation, whereby domestic systems borrow from one another.[70] Weiner also describes international treaty-making as a "game" whereby a domestic legal concept requires "the entrepreneurial efforts of proactive borrowers," of "change agents" to be incorporated into an international treaty, a complex effort that includes NGOs, lobbyists, and academics, among others.[71] Harold Koh has described a similar process he calls "vertical domestication" when international law norms "trickle down" to be incorporated into domestic legal systems."[72] Similar to Berkowitz, Pistor and Richards, Koh argues that whether or not an international norm is incorporated

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Global Law Without a State (Dartmouth: Aldershot, 1997) at 1–11.

67 Teubner, *supra* note 15 at 16.

68 Katharina Pistor & Philip Wellons, *The Role of Law and Legal Institutions in Asian Economic Development 1960-1995* (Oxford: Oxford University Press, 1999) at 36–40.

69 Nelken, *supra* note 38 at 30–32.

70 Jonathan B Wiener, "Something Borrowed for Something Blue: Legal Transplants and the Evolution of Global Environmental Law." (2001) 27:4 Ecol Law Q 1295 at 1297.

71 *Ibid* at 1344–1349.

72 Harold Hongju Koh, "Bringing International Law Home." (1998) 35:3 Houst Law Rev 623 at 626–627.

domestically or not is dependent more on the degree to which the receiving country actively participates in the "transnational legal process" than on any inherent feature of its legal system or the norm itself. States are compelled to integrate international law domestically because such participation "creates an internalizing, normative and constitutive dynamic" that is variable and contextual and driven by "six key agents": "transnational norm entrepreneurs"; "governmental norm sponsors"; "transnational issue networks"; "interpretive communities and law-declaring fora"; "bureaucratic compliance procedures"; and "issue linkages".[73]

Conclusion

The scholarly literature on legal transplantation is abundant and diverse, but also fragmented and divided. The great law-society paradigms in the style of Watson and Legrand that sought to explain transplants in terms of legal change writ large ran aground on critiques from scholars like Cotterrell and Teubner, who challenged their universal claims with arguments about the highly variable complexities that underlie such processes. For some, these complexities are so great that seeking out a general theory to describe them is pointless because "there are simply too many variables to support testable propositions of cause and effect."[74] Assuming that is true, or at least acknowledging the difficulty of that task, grand theory has been replaced in recent years by more manageable and focused studies of individual features of transplant processes. While able to explain how particular aspects of the phenomenon work in certain or some cases, these studies individually struggle to explain coherently why certain outcomes emerge over others when legal transplants are used to bring about legal change. Whether one turns to Sacco to explain how 'formants' affect legal change, or to Dezelay and Garth or Weiner to explain how globalization and geopolitics cause legal norms to travel around the world, or to Miller's path dependency typology to categorize transplant processes, the nature of the whole is left unexplained, and it is far from obvious how together they collectively can explain why law evolves, or does not evolve, the way it

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[73] *Ibid* at 647, 680.

[74] John Gillespie, *Transplanting Commercial Law Reform : Developing a "Rule of Law" in Vietnam* (Aldershot, England; Burlington, VT: Ashgate Pub. Co., 2006) at p.16.

does when it is transplanted elsewhere.

Thus, William Ewald's scholarly call for a more sophisticated and complex law and society model to explain legal transplants has yet to be answered. Yet, without one, the scholarly discourse about transplants will continue to be fragmented and disparate, and its utility will be limited for anyone seeking broadly and consistently applicable analytical tools or methods to apply to legal reform processes. Chapter 2 will explore more deeply why legal transplantation has proven so difficult to capture by theory and will then offer a possible methodological way around these difficulties to pave the way for a contemplation of a methodological approach that can accommodate most, if not all, of the contributions of the authors surveyed here.

CHAPTER 2

Legal Transplants From a Systems Perspective

Introduction

The previous chapter demonstrated that the current academic discourse about legal transplantation is fragmented and characterized by disagreements over questions about law's relationship to society, the relative importance of "context", and how law is determined by its social environment. This chapter will ask what it is about the study of transplants that produces such theoretical cleavages, and how it may be possible to overcome them and somehow unify these fragments of transplant theory into a coherent whole. It will identify what common ground exists among transplant theorists in spite of their differences, and will then propose a methodological approach built upon that common ground with insights from systems theory that together can address these conceptual barriers. The outcome of this analytical exercise will then become the foundation for a new methodological approach to studying legal transplants that will be offered in Chapter 3.

Common Grounds

Given the depth of some of the cleavages separating some legal transplant scholars, finding common ground among them is not particularly easy. However, there is at least a basic consensus among the authors surveyed in the previous chapter that legal transplantation is a phenomenon of legal change that emerges out of the introduction of an external law, rule or norm into a particular domestic legal, social, political and economic context. Whether or not the transplant succeeds in achieving a desired legal change is somehow determined, or at least affected by, complex, overlapping social relationships and interactions of multiple communities, institutions and normative frameworks, all of which generate a highly variable range of possible transplant

outcomes that are difficult to predict. Many of the authors in Chapter 1 were preoccupied with understanding the relative importance and impact of these sorts of complex relationships. While Watson's central thesis was that legal transplantation was possible because of the *lack* of a strong relationship between law and society, Legrand argued that the opposite was true. Teubner's "irritant" thesis is a relational one, describing a legal norm's interaction with its receiving environment, while Ewald's call for a new theoretical paradigm searched for a more sophisticated way to understand how law and society are related. Kahn-Freund's definition of "context" as a struggle between group interests is inherently relational, as are Sacco and Cotterrell's descriptions of law as a battleground of competing formants and communities of interests, as well as Dezelay and Garth's 'Palace Wars' concept. Even Mattei and Ajani's discussions about "prestige" and "efficiency" factors are relational when understood as characteristics attributed by actors to a transplanted law. Any approach seeking to unify and accommodate this array of scholarship, therefore, will have to make these complex, interactive, and relational characteristics a key, if not a central, consideration and focus.

Law does not easily imagine processes of legal change in a relational setting. Positivist accounts of law, for instance, look to political action and law's formal structures and instruments to explain legal change, validity and meaning.[75] Rather than making contextual relationships analytically central, positivist approaches instead make them peripheral to law's contents and institutions, which they understand to be fixed rather than relational. Such accounts therefore are not well suited for the needs of transplant theory. Legal anthropological studies of cultural and institutional discourse might appear more promising because of their interest in relational structures within legal cultures.[76] However, they too are of limited use for studying transplants because legal

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[75] This is not to suggest that legal positivists deny "context". James Gardner, for instance, suggested a possible connection between positive law and political relationships by suggesting that the former can provide structure to the latter, but that it is the latter that determines whether or not this will happen: "maybe the fact that Rex is a noble King explains why his subjects, or his officials, have come to regard his word as law. But it is his word that they regard as law. For his word to be regarded as law it must be possible to regard his word as law without reopening the question, when his word is heard, of whether he is a noble king." James Gardner, "Legal Positivism: 5 1/2 Myths" (2001) 46 Am J Juris 199 at 201

[76] Sally Engle Merry, "Anthropology, Law, and Transnational Processes" (1992) 21 Annual Review of Anthropology 357 at 360; John M, O'Barr & William M, Conley, *Rules Versus Relationships : the Ethnography of Legal Discourse* (Chicago: University of Chicago Press, 1990); Elizabeth Mertz,

anthropologists typically go "beyond the question of how law works [to] ask how our society is regulated."[77] Anthropological attentions tend to focus on understanding the place and functions of individual roles within society,[78] how the meaning of "law" is constructed by members of a community,[79] and how that meaning is informed by status and social relationships.[80] Legal transplant scholars, however, are interested in the opposite. They want to determine *how* law works by understanding how society affects law, not the other way around. If neither positivists nor anthropologists can help with making complex, interactive and changing relational structures central to legal analysis, inspiration perhaps should be sought elsewhere.

This paper argues that one possible source of such inspiration is 'systems theory,' a heterogeneous field of scientific inquiry that is specifically devoted to studying complex interactions.[81] Systems theorists are generally interested in mass phenomena whereby "a myriad [of] individuals organize themselves into a dynamic, volatile, and adaptive system that… evolves mainly according to its intricate internal structure generated by the relations among its constituents".[82] The field originated in the 1950s with the work of Ludwig von Bertalanffy who observed that when conventional scientific explanations reduced observable phenomena in nature down to their individual elements they lost sight of the system-like properties created by their interactions. Bertalanffy looked to how the interplay of elements instead constituted scientific phenomena in their own right that were distinct from the elements themselves. His work explored notions of "'wholeness', i.e. problems of organization, phenomena not resolvable into local events, dynamic interactions manifest in difference of behaviour of parts when isolated or in a higher configuration, etc.; in short, 'systems' of various order not understandable by

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"Language, Law, and Social Meanings: Linguistic/Anthropological Contributions to the Study of Law" (1992) 26:2 Law Soc Rev 413.

77 John M Conley & William M O'Barr, "Legal Anthropology Comes Home: A Brief History of the Ethnographic Study of Law" (1993) 27 Loy Rev 41 at 61.

78 *Ibid* at 47.

79 For example Sally Engle Merry, *Getting Justice and Getting Even: Legal Consciousness Among Working-Class Americans* (Chicago: University of Chicago Press, 1990).

80 Conley & O'Barr, *supra* note 76 at 58.

81 Steven E. Phelan, "A Note on the Correspondence Between Complexity and Systems Theory" (1999) 12:3 Systemic Practice and Action Research 237 at 238.

82 Sunny Y. Auyang, *Foundations of Complex-System Theories : in Economics, Evolutionary Biology, and Statistical Physics* (Cambridge: Cambridge University Press, 1998) at 1.

investigation of their respective parts in isolation."[83] Since his time, there has been a massive expansion of interest in systems in many fields with innumerable applications, so much so that categorizing systems approaches as a homogenous field itself is challenging.[84]

Around the same time that Bertalanffy was developing his new systems theories, studies of 'legal systems' and 'families' of legal systems had become popular in the field of comparative law to classify and explain how legal and procedural norms manifested themselves differently in different countries.[85] The classic studies from that era, like René David's *Traité élémentaire de droit civile comparé: Introduction à l'étude des droits étrangers et à la méthode comparative*[86], or Joseph Raz's *The Concept of a Legal System*,[87] treated legal 'systems' quite differently from the way Bertalanffy approached the 'systems' he observed in science. Scholars like David and Raz employed bounded models that depicted law as a hierarchical, closed and logically ordered construct of rules that were subservient to state authority and understood in terms of their normative content.[88] This concept of a 'legal system', however, is far removed from the variable, heterogeneous, complex and interactive phenomena that both legal transplant scholars and systems scientists are interested in. Indeed, such hierarchical renderings of law have been subject to much criticism over the past half-century. Critical legal scholars, for instance, criticized their formalized system constructs for not reflecting how law actually works in reality.[89] Alan Watson himself argued that because such 'legal systems' often copied and shared features with one another, their boundaries were too blurred for the term to retain any scholarly or intellectual substance worth using or investigating

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83 Ludwig von Bertalanffy, "The Theory of Open Systems in Physics and Biology" (1950) 111 Science 23 at 24.

84 Peter Checkland, *Systems Thinking, Systems Practice* (New York: J. Wiley, 1981) at 115; Alex Ryan, *A Multidisciplinary Approach to Complex Systems Design* (PhD Thesis, University of Adelaide, 2007) [unpublished] at 66.

85 H Patrick Glenn, "Comparative Legal Families and Comparative Legal Tradition" in Mathias Reimann & Reinhard Zimmermann, eds, *Oxford Handbook of Comparative Law* (Oxford: Oxford University Press, 2006) 421.

86 René David, *Les grands systèmes de droit contemporains : (droit comparé)* (Paris: Dalloz, 1964).

87 Joseph Raz, *The Concept of a Legal System; an Introduction to the Theory of Legal system.* (Oxford: Clarendon Press, 1970).

88 Julius Stone, *Legal System and Lawyers' Reasonings* (London: Stevens, 1964).

89 Roberto Mangabeira Unger, "The Critical Legal Studies Movement" (1983) 96:3 Harv Law Rev 561; Mark V Tushnet, "Perspectives on Critical Legal Studies: Introduction" (1984) 52 Geo Wash Rev 239.

further.[90]

This paper will examine legal transplants through the perspective of 'legal systems,' but will take its cue from Bertalanffy, rather than Raz or David, to do so. For the purposes of studying legal transplantation, a legal 'system' here will be understood first and foremost as a model describing complex, networked, interactive behaviour of interdependent individuals and institutions that are related in some manner to issues or concerns of a legal nature, broadly defined. It is the collective behaviour of these individual system constituents that generates a system's overall properties. The behaviour and worldview of these constituents may be autonomous and idiosyncratic, or they may be governed by overarching designs and formal, rule-based normative frameworks, yet collectively they have a cohesive unity, operating together as a 'system'.

Although the term 'legal system,' is vernacularly common, the actual study of the systemic properties of law in this broader sense is quite rare.[91] In other disciplines, ranging from biology to materials sciences to astrophysics and meteorology, studies of complex systems are far more common.[92] While transplant scholars readily acknowledge the social complexity of the phenomenon they study, most have attempted explanations in spite of that complexity, trying to downplay its effects. In order to appreciate how a study of law might instead embrace that complexity as its methodological foundation, a brief overview of systems theory is required, and is offered below. This will be followed by a review of the impact that such a perspective would have on the key conceptual obstacles and challenges that legal transplant theorists must regularly face.

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[90] For Watson, "an elementary account of various legal systems or of various 'families' of systems cannot be decently regarded as the proper pursuit of Comparative Law as an academic activity. The description lacks the necessary intellectual content." Watson, *supra* note 22 at 4. To be fair, however, in the field of comparative law, both during and since David and Raz's time, there has been little consensus on any single way of categorizing legal systems, either based on their normative content or otherwise, as Jaako Husa has pointed out. Jaako Husa, "Classification of Legal Families Today. Is it time for a memorial hymn ?" (2004) 56:1 Rev Int Droit Comparé 11 at 16–17.

[91] J B Ruhl, "Complexity Theory as a Paradigm for the Dynamical Law-and-Society System: A Wake-Up Call for Legal Reductionism and the Modern Administrative State" (1996) 45:5 Duke Law J 849 at 903.

[92] Alex Ryan lists a number of systems approaches that have evolved since the birth of systems thinking in the 1940s and 50s: complex systems, nonlinear dynamical systems, synergetics, systems engineering, systems analysis, systems dynamics, soft systems methodology, second order cybernetics, purposeful systems, critical systems thinking, total systems intervention, and systemic therapy. Each of these has been applied broadly to all fields of science, as well as spawning the creation of new areas, such as systems biology. Ryan, *supra* note 84 at 48.

Systems Basics

'Systems' in their simplest and broadest sense are singular entities made up of components that interact in some sort of non-random, organized, networked fashion. Whether talking about ecological systems, the internet, factories, or colonies of army ants, to name a few, the properties of a system's components (flora and fauna, computers and servers, workers and supervisors, or soldier ants and worker ants) as well as their structures, organization and component interactions are understood in reference to the system as a whole, even if the whole is not governed by any single authority or set of rules.[93] A snapshot of a system at any given time will aim to describe the system's large-scale phenomena as being produced by the aggregate behaviours of its micro-level constituents.[94] Systems are considered "complex" when they are composed of networks of individuals whose interaction is uncertain and variable, which, when aggregated, have non-linear causal effects producing system-wide phenomena that are not observable at the micro-level and are difficult to predict.[95] Simple definitions of complex systems are difficult and vary from discipline to discipline. One of the most succinct is offered by Peter Coveney: "macroscopic collections of [interacting] units that are highly endowed with the potential to evolve in time."[96] J. B. Ruhl offers another, describing them as systems whose "behaviour emanates from a multitude of diverse, dispersed sources responding to co-evolving interactions, feedback loops, and nonlinear cause-and-effect properties."[97]

'System dynamics' is a sub-set of systems theory that seeks to explain how and why systems change in terms of how they use and process information to control and regulate

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93 Yasmin Merali & Peter Allen, "Complexity and Systems Thinking" in Peter Allen, Steve Maguire & Bill McKelvey, eds, *SAGE Handbook of Complexity and Management* (London: SAGE Publications, 2011) 31 at 32; Thomas C Schelling, *Micromotives and Macrobehavior* (New York: Norton, 1978) at 21. Schelling offered the ant colony as a classic example of a complex system that is coherent but lacking any central governing structure: "It is generally not believed that any ant in an ant colony knows how the ant colony works. Each ant has certain things that it does, in coordinated association with other ants, but there is nobody minding the whole store. No ant designed the system."

94 Auyang, *supra* note 82 at 61–62.

95 Melanie Mitchell, *Complexity : a Guided Tour* (Oxford: Oxford University Press, 2009) at 12.

96 Peter Coveney & Roger Highfield, *Frontiers of Complexity : the Search for Order in a Chaotic World* (New York: Fawcett Columbine, 1995) at 7.

97 Ruhl, *supra* note 4 at 22–23; Edward L Rubin, "Law and the Methodology of Law" (1997) Wis Law Rev 521 at 527.

component interaction with external stimuli and internal fluctuations. Information feedback cycles run through a system from layer to layer, changing the behaviour of system constituents, which, in turn, cause changes to the overall character of the system itself.[98] When a system is not changing, it is understood to be in a state of 'equilibrium', whereby a system's constituents, for whatever reason, withstand external influences and internal fluctuations in order to either keep the system immobile or to return it to its former position after having been disturbed. A system that is in equilibrium is therefore stable when these external and internal disturbances are not strong enough to bring about systemic change. A system in equilibrium, therefore, can be described as having relatively little potential for change.[99] The corollary to this is that systems that are not in equilibrium can be said to have a greater likelihood of experiencing change because of their being unable to constrain or maintain the consistent behavioural patterns of their constituents. In this way, system equilibrium dynamics provides an important basis upon which it is possible to explain how and why systems change, or do not change, when they encounter forces that disturb its internal structures.

Unfortunately, there is nothing simple about identifying equilibrium dynamics in a complex system. A system's multilateral and interconnected internal composition, combined with the variety of ways in which system constituents interact with each other and their external environment, provide a system with a range of possibility and capacity for change that can be highly complex and difficult to grasp theoretically.[100] This complexity challenge was identified repeatedly by a number of scholars in Chapter 1. For other scholars, such as John Gillespie for instance, this problem is so great that they advocate abandoning any attempts to tackle it at all.[101]

However, the advantage of taking a broad and permissive conceptualization of systems, in spite of the challenge of inviting complexity, is that it also permits great flexibility in the way that one can model whatever legal 'system' is being studied. If the predominant underlying question that permeates every discussion about legal transplants is the problematic relationship between law and society, then a systems perspective could

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98 Merali & Allen, *supra* note 93 at 34.
99 Auyang, *supra* note 82 at 77–78, 205.
100 *Ibid* at 1.
101 Gillespie, *supra* note 74 at 1.

model that relationship in a great number of ways. The disagreements outlined in Chapter 1 about whether or not "law" and "society" were independent of one another, independent but interacting, or completely dependent or inter-dependent, for example, surface when trying to conceptualize a systemic model for that relationship. If 'systems' are understood to be analytical tools, rather than actual things existing in reality, an observer is left free to adopt as broad or as restricted a focus as suits his or her explanatory objectives. This allows for a single, malleable methodological approach that could work equally well among many different disparate perspectives on legal transplants, regardless of how one conceives of the law-society paradigm.

Most of the scholars identified in Chapter 1 that have an interest in law and "context" tend to view law and society as two vaguely defined, multi-bodied entities that interact in a complex fashion. A 'systems' model for legal transplants could depict this in many ways. It could regard legal transplantation as a process running through a legal system that is itself a constitutive feature and aspect of an even larger 'society' system. Such a model might appeal to those writers wanting to emphasize the determinative nature of external social context on transplantation processes, such as Cotterrell, Nelken, and Legrand. Alternatively, one could view transplants as a process of systemic change within a legal system that is distinct from its general external social environment, or that is operating semi-autonomously within a society system. Teubner, for instance, tends to depict law as a process or a characteristic produced by particular relationships within a larger "society" system.[102] Alan Watson might advocate this approach also, although given his disdain for the term "legal system," he would probably deny that there was anything 'systemic' about his theory all. A third approach could view legal normativity as a distinct entity itself, with legal transplantation being an event or process through which that normativity interacts with domestic legal and social systems. Harold Koh's take on globalization and international law, for instance, could fit such an approach. These are only three of many possible constructs.

Because the potential uses of systems perspectives are so variable, choosing how to depict reality with them will always require that the observer make a conscious and

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[102] Gunther Teubner, "Autopoesis in Law and Society: A Rejoinder to Blakenburg" (1984) 18 Law Soc Rev 291 at 293.

explicit choice of one system model over others. Whether or not any choice is 'correct' will depend on the explanatory objectives of the observer and the model's relative capacity to achieve them. To believe that one system exists in any essential sense to the exclusion of others risks the epistemological mistake of equating appearance, or models that explain appearances, for reality.[103] Rather, in the words of Alex Ryan, "knowledge that is obtained using a systems approach makes more sense when it is seen as one perspective for thinking about the world, rather than an objective property of bounded regions of space-time."[104] Although quite abstract, "systems" understood this way are not very different from attempts that others have made to grapple with the complexity of transplantation. Cotterrell, for instance, describes the "communities" within a legal system more as abstract analytical concepts than as tangible objects. He is careful to remind his readers that law does not attach itself to abstract concepts like "community", but rather to the actual complex social relations that the concept of "community" tries to describe.[105] 'Systems' are no different.

'System' Responses to Legal Transplant Methodological Challenges

With this very brief introduction to systems theory, it is now possible to contemplate how a systems approach might address the core methodological and epistemological challenges with which legal transplant scholars regularly struggle. The objective of this thesis is to overcome the cleavages in the field and re-assemble its fragmented perspectives, thus discussing these challenges will lay the groundwork for a systems-based modelling strategy to overcome them that will follow in the following chapter.

Scale: Trading Off or Balancing the General and the Specific

Legal systems, in their broadest sense, can be enormous, complex and variable, and theories attempting universal or comparative descriptions of them often must strike a balance between the specific and the general in order to maintain coherence with their

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[103] Teubner labels this distinction as the difference between "epistemological realism" and "epistemological constructivism," noting that the later is related to post-modern sociological notions of the "social construction of reality." Gunther Teubner, "How the Law Thinks: Toward a Constructivist Epistemology of Law" (1989) 23:5 Law Soc Rev 727 at 730.

[104] Ryan, *supra* note 84 at 49.

[105] Cotterrell, *supra* note 36 at 83.

analytical objectives. Scholars like Alan Watson that have attempted grand theoretical explanations of legal transplantation have received criticism for the loss of empirical relevance that their comprehensive approaches bear proportionate to the degree of generalization they attempt.[106] For instance, imagining a legal transplant as the intersection between two different legal "families," such as if a Common Law rule was transplanted into a Civil Law jurisdiction, would require a very broad scale of analysis. Such an analysis would need significant generalizations about what the 'Civil Law' and the 'Common Law' are as singular things, any of which might not hold up when compared to any particular Civil or Common Law jurisdictions. Inversely, examining a transplant of a particular English Common Law principle into Quebec's Code of Civil Procedure, to take a similar example, would require a specific analysis, perhaps rooted in the respective legal traditions or doctrinal frameworks, that would have to sacrifice any general, global claims about the 'Common Law' or 'Civil Law.' Both the broad- and specific-scale approaches would be perfectly valid for their respective projects, but would produce inaccurate conclusions if applied to the other. In this way, the broad and general must be traded off for the specific and vice versa. This produces an impasse for legal transplant scholars. How can it be worthwhile to pursue a general theory about transplants if every empirical example of a transplant process will generate a specific, unique and contextual outcome, different from any other?

A 'systems'-based approach can avoid this specific-general trade-off by contemplating the systemic connections between the dynamic relationships of actors at a system's micro-level with the system's overall, macro-scale properties. In other words, claims about a system's shape, movement, adaptability, and capacity for change can be made while still acknowledging the variability of behaviour at a system's micro-level.[107] When legal change is described in terms of the aggregation of changes in a legal system's micro-level component behaviours, one is freed to speak about micro-processes and macro-effects simultaneously, rather than having to trade off one for the other.[108]

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[106] *Ibid*.

[107] Auyang, *supra* note 82 at 4.

[108] In the Common Law/ Civil Law examples used earlier, one would ask how the macro-impression of the "Civil Law" system might be altered or changed by the micro-level change caused by the "Common Law" principle, or how the transplant affects the general, global impressions of actors in the

Although macro system characteristics can be explained in terms of micro constituent behaviour, macro system characteristics are not necessarily evident or identifiable at the micro-level. The Internet, for instance, is not visible anywhere within a single computer, just as one cannot really see an entire legal system within the behaviour of any single judge or case ruling. Rather, it is the aggregate effect of all micro phenomena, such as the combined behaviour of all computers, or of all judges and case law, within a system that provides it with its macro properties.[109] It is important to emphasise, however, that a macro system property is not a rule or law determining micro behaviour, but rather a macro effect produced by mass micro behaviour. It is for this reason that one must treat with caution legal transplant theories that purport to identify universal laws in micro-processes. Ugo Mattei's treatise on "efficiency," for instance, is useful as a description of a particular kind of rational calculation made by actors in transplant processes, but becomes problematic when it is assumed to also be an inherent systemic principle that dictates universal, system-wide behaviour.[110] The most that a systems approach could say instead would be that the aggregate efficiency-seeking behaviours of transplant actors might provide a legal system with a macro-impression of being generally efficiency-seeking, but could not guarantee efficient outcomes in every case.

Delineating Systems and Locating Transplants

The central preoccupation among theorists that the interaction between "law" and "society" somehow determine legal transplant outcomes implies a concept of boundaries that needs further clarification. Do the two intersect like circles in a Venn diagram? Or is one situated within the other like an egg yolk surrounded by white? Or is one a feature

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legal system of what the "Civil Law" and "Common Law" are. Another example of this would be Katz and Stafford's study of peer effects in the American judiciary. Their study used law clerk traffic as a means of creating a social prestige network among judges, arguing that the behaviour of American federal judges is influenced in part by their positions within the social structure of the hierarchical system of the federal judiciary. Daniel M Katz & Derek K Stafford, "Hustle and Flow: A Social Network Analysis of the American Federal Judiciary" (2010) 71:3 Ohio St L J 457.

109 See Schelling, *supra* note 93.

110 Consider, for instance, the following comment from Mattei: "From the point of view of a given legal system, efficient is whatever avoids waste; whatever makes the legal system work better by lowering transaction costs; whatever is considered better by the consumers in the legal marketplace; whatever, in other words, does not pointlessly foreclose the development of a better organized human society; whatever legal arrangement 'they' have that 'we' wish to have because by having it they are better off." Mattei, *supra* note 51 at 19.

that runs through the other, like a vein of gold in a mountainside, or the electrical wiring in a building? Or are they simultaneously all of these?

J.B. Ruhl has described the conceptual difficulty that this poses for scholars:

> What is far from obvious is how law and society, each a context for the other, interact. If society evolves in a response to changes in law, and vice versa, then law and society must co-exist in an evolving system. Each needs the other to define itself. Yet, most commentary on "law and society" has been devoted to explaining how one element of that system reacts to the other - how law reacts to society, or how society reacts to law… the manner in which the two subcomponents of the system made up of law and society interact cannot be fully understood through such disaggregation. One "side" does not "lead" the other, and any attempt to understand how to have one do so to the other, or to predict the outcome of such efforts is doomed from the start.[111]

The pervasive mutability and contextual variability of law and society relations are problematic when either or both are conceived of as systems. For each to be subject to external influence by the other, both must be open-ended. This openness presents a methodological difficulty when one tries to articulate where their boundaries are or to locate any process or event running through them.[112] As seen in Chapter 1, comparative law studies from half a century ago avoided this problem by assuming that legal systems were closed doctrinal and procedural systems, whose boundaries correlated with social and political boundaries, thereby permitting their classification in terms of national-cultural system types or legal 'families.'[113] However, if a 'legal system' is conceived of as something that freely interacts with and responds to external inputs from its surrounding environment, such as from 'society', for instance, then boundaries become less tangible and demand explicit methodological choices for their articulation. Such boundary choices are as variable and numerous as the 'systems' that one can study. They

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[111] Ruhl, *supra* note 91 at 851.

[112] Auyang, *supra* note 82 at 90.

[113] Glenn, *supra* note 85 at 424. The concern here is that such a boundary choice is a methodological one, not an essential one. Early scholars of "legal families" and the like may have disagreed that theirs was a purely methodological choice because they may have believed that such classifications reflected observed reality, rather than an interpretation. There is a great deal of difference, however, between saying that there "is" a German legal system, family of systems or tradition, as opposed to saying that identifying a "German legal system" is an analytical tool that allows for certain interpretive claims to be made about how and where a particular form of law occurs.

can range from the specific (ex. a financial securities regulation system) to the general (ex. anything "law-related") with the appropriateness of their boundary choices dependant on the nature of the question at hand.[114] Günther Teubner's 'legal irritants' thesis, for example, could be seen as a model of a particular type of intersection of law with society, whereas Watson's classic "transplant" model would see the legal system as something more bounded and separate from society.[115]

When law is seen as a systemic environment of one sort or another, decisions about how to characterize a legal transplant will affect how and where it is located within that system. If a transplant is understood to be an external object that is introduced into a domestic system, then analysis will seek out its effects in terms of system changes in response to that introduction. Such studies could look to see whether a transplant is 'accepted' or 'rejected' by a receiving system, or the relative capacity of the system to embrace or resist the change the transplant proposes, or whether the two 'fit' together. A number of the 'grand theory' scholars studied legal transplants in this way, asking questions about the transplantability or survivability of foreign laws or rules in different environments through time (Watson and Kahn-Freund), or the difficulty of transporting their norms and meanings independent from their socio-cultural heritage (Legrand).

Alternatively, seeing legal transplantation as a process within a system will have quite a different effect. Doing so shifts attention away from the material content of a transplanted law or norm towards things like information flows, constituent power relationships, and forms of interaction between system constituents participating in and controlling that process. What is important for process-oriented descriptions of transplants is not so much the content of transplanted laws or rules, but rather what system actors choose to do with them, and how and why such actions cause any adaptation or modification of the transplanted law and/or the receiving system. Miller's typology of transplant types might be an example of this, one that sees the socially or politically dictated form that the transplant process takes as determining the path that its

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[114] Lynn LoPucki, "The Systems Approach to Law" (1997) 82 Cornell Rev 479 at 488–489.

[115] Watson acknowledged law as being autonomous, but not unattached to social forces. He argued that law could exist separate from and sometimes in direct contrast to the best interests of society because it often represented the interests of particular groups rather than "society" as a collective whole. Watson, *supra* note 5 at 8–9.

evolution will take.

A third alternative would be to see legal transplants simultaneously as both objects *and* processes of legal change, whereby an object is inserted into a domestic system by both domestic and external actors, which causes a systemic response as system constituents shift their behaviour to receive, accommodate, digest, alter and/or reject it. Teubner's 'legal irritants' theory could be an example of this. A variation might be to view a transplant as both an external object as well as an internal variable representing legal reform choices made by domestic actors or institutions. Analysis in such cases will turn towards internal system instabilities or aggregate desires for systemic change that create opportunities for transplanted norms to flourish or die. Berkowitz, Pistor and Richard's concept of "system health", as well as Dezelay and Garth's "Palace Wars" theory, are examples of this sort of explanation.

Context, Social Norms and Information

There is consensus in the literature surveyed in Chapter 1 that 'context' somehow matters for legal transplants. There is little agreement, however, about what exactly 'context' is, how much it matters, or how its effects can be measured and explained. If one chooses to see law as a complex open system, however, 'context' will become relevant primarily when one tries to explain the behaviour and interaction of system components with each other and with their external environments. If, for example, a constituent within a legal 'system', whether an individual, an institution or a community, acts upon a legal transplant by either accepting, implementing, adopting, modifying, or rejecting it, one can expect that they will do so in a way that corresponds to the manner in which they perceive the contextual circumstances they find themselves in.[116] 'Context' in this sense can be imagined as the variety of factors that structure perceptions that system constituents have about their circumstances and that influence their choices. It encompasses the strategic, moral, historical and emotional frameworks through which individuals or institutions decide what to do when they encounter a legal transplant.

Identifying contextual variables and measuring their effect is difficult to do with

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[116] Auyang, *supra* note 82 at 60–61.

certainty. A straightforward route would be to assume that individuals act in ways determined by the external normative frameworks imposed upon them by society.[117] However, when an individual or institution is acknowledged to have interactive, networked relationships with a multitude of others in a complex legal or social 'system,' then it would be quite limiting to claim that they behave the way they do simply because they robotically receive and implement orders from external social norms. Such a claim is left vulnerable to the awkward follow-up question of where the social norms would come from in a world of robots. Indeed, the more difficult and complex reality is that actors are simultaneously recipients of, and contributors to, normative influences in society through their participation in it, but at the same time are not necessarily determined by them at any given time. Trying to capture this ambiguous dynamic and account for all of its complex manifestations in a system is a significant challenge for any attempt to understand, much less predict, transplant outcomes.

Game theory is a methodological tool that can help tackle this challenge. Game theory studies examine strategic decision-making in networked settings by using and comparing models of structured 'games' where a number of players are faced with decision-making situations framed in terms of information, actions and payoffs.[118] Outcomes of games are explained according to what rationales lead actors to make the choices that they do. Not all game outcomes will be the same because individuals are different and may behave differently, and for different reasons, when faced with the same game situation. Their choices are variable, based on their individual, subjective speculations about the world, their expectations about the behaviour of others in the game, their opinions about proper or desirable outcomes, as well as personality characteristics, such as their instincts, doubts, and inclinations to take risks.[119] Choices can be purposive, principled and unilateral, or contingent and reactive towards the

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[117] Robert Cialdini, Carl Kallgren & Raymond Reno, "A Focus Theory of Normative Conduct: A Theoretical Refinement and Reevaluation of the Role of Norms in Human Behaviour" (1991) 24 Advances in Experimental Social Psychology 201. Cited in; Cristina Bicchieri, *The Grammar of Society : the Nature and Dynamics of Social Norms* (New York: Cambridge University Press, 2006) at 3.

[118] The famous "Prisoners' Choice" game is but one of many examples of such "games". Eric Rasmusen, *Games and Information: An Introduction to Game Theory* (Oxford: Wiley-Blackwell, 2007) at 10.

[119] Auyang, *supra* note 82 at 340.

behaviour others playing the same 'game.'[120] Despite this great potential individual variety, however, it is often possible for an observer to draw conclusions about player behaviour by gleaning patterns from the aggregate game outcomes and behaviours of players involved in repeated and ongoing games.[121]

The relevance of game theory principles for legal transplant studies is that they offer a conceptual basis to explain patterns of system behaviour in terms of incentive-based, contextualized decision-making by system actors over time. This is not a new or novel use of game theory, or game theory concepts. Matt Andrews, for instance, links "context" to institutional actor behaviour through what he calls "logics," a blend of decision-making rationality with socio-cultural discourse, that are "rule-like… that [shape] how agents understood their world, what they deemed appropriate, what they were willing to enforce, and how they planned to do so."[122] Similarly, when Gunther Teubner once described the incorporation of German "good faith" principles into British contract law, he acknowledged the existence of "extra-legal rule-making machines" that both bound law and separate it from other social discourses that "are driven by the inner logics of one specialised social domain and compete with the legislative machinery and the contracting mechanism."[123]

Christina Bicchieri's study of social norms is an example of a study explicitly rooted in game theory, and it is particularly useful here because it examines normative context as something that emerges "through the decentralized interaction of agents within a collective… not imposed or designed by an authority."[124] Such norms refer to "behaviour, to actions over which people have control, and are supported by shared expectations about what should/should not be done in different types of social situations."[125] The direct, underlying motives that drive action are "the beliefs and desires

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[120] Schelling has noted that, "[w]ith people, we can get carried away with our image of goal-seeking and problem solving. We can forget that people pursue misguided goals or don't know their goals, and that they can enjoy or suffer subconscious processes that deceive them about their goals." Schelling, *supra* note 93 at 18.

[121] Rasmusen, *supra* note 118.

[122] Matt Andrews, *The Limits of Institutional Reform in Development* (Cambridge: Cambridge University Press, 2013) at 47.

[123] Teubner, *supra* note 15 at 18–19.

[124] Bicchieri, *supra* note 117 at x.

[125] *Ibid* at 10.

that support the norm" and "the behaviour of others [that] provides us with information about appropriate courses of action."[126] The implication of this for a systems approach to legal transplants is that it allows for changes to individual or institutional behaviours to be explained in terms of changes to expectations derived from norms, rather than from the norms themselves. Thus, the mere existence of a contextual norm will not be enough to explain or predict individual behaviour. Rather, behavioural explanations will have to appreciate that normative entrenchment can differ and vary greatly among actors, providing different expectations of reciprocity, sanctions or payouts, with different effects on their decision-making calculations.

The enormous importance of this for a systems model is that it allows for an explanation of how and why actor behaviour can vary within the same normative environment. Rather than sources of robotic behavioural instructions, social, legal or other norms are instead lenses through which actors interpret and choose to act upon the 'context' in which they find themselves.[127] Norms have a variable and idiosyncratic, rather than determinative, effect on actor behaviour because such behaviour results from choices that follow individual interpretations of both norms and the context in which they are being acted upon. One cannot simply presume, therefore, that because of its content an transplanted, imported norm will be important for actors in a legal system. Instead, one can only measure its importance by observing how much it impacts system actor behaviour. Indeed, descriptions of context without reference to the mechanisms by which norms affect actor behaviours and action will have little, if any descriptive or prescriptive power in a system model.[128]

Thus, even though it is difficult to point out or positively identify 'context' anywhere in legal or social systems, one can still claim its presence within them because its effects can be observed in actor behaviour. Furthermore, in interdependent, interactive systems actor behaviours themselves become part of the general context of other actors within them as everybody's behaviour is affected by, and in turn affects, that of everybody else. In this sense, 'context' acts as a kind of information that flows through a system to

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[126] *Ibid* at 22, 30.
[127] Auyang, *supra* note 82 at 117.
[128] Bicchieri, *supra* note 117 at 7.

structure agent behaviours. These then later return as system feedback when individual behaviours collectively contribute to aggregate community behaviour trends, which are then perceived by individuals and possibly affect further behaviour and choices.[129]

Change, Dynamism, Predictability and Possibility

Legal transplantation is a form of legal change that occurs over time. Describing change within a system after the introduction of a legal transplant is a search for that system's dynamic properties and requires answering how and why a system moves from one state to another within a period of time. To describe "change" is to describe the difference in a system's state or condition between two or more events, accompanied by a causal explanation for why the change occurred.[130] Historical narratives are well suited to this task because they describe a chain of change events from an initial position through time. It is no coincidence that the foundational text on legal transplants was a work of legal history.[131] The foundation of Watson's theory on the relative autonomy of law from society came from his study of the historical record, which documented changes to domestic legal systems through the introduction of foreign laws or norms, and also the lack of change in legal frameworks over time irrespective of society's needs.[132] As a retrospective account of legal history, Watson's work is convincing. However, historical narrative is considerably less convincing when applied to the present, and downright problematic when projected into the future. Historians do not make good fortune-tellers.[133]

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[129] Auyang, *supra* note 82 at 121.

[130] *Ibid* at 327.

[131] Consider Watson's claim on the central importance of legal history for any legal analysis: "the present shape of a rule of private law has more to do with history than with the present structure of society. 'History' here is used in the widest possible sense: history of the nation, its feuds, intellectual contacts, past social, economic and political conditions and its languages; history of legal life, the activity of the legislature, powers of the interpreters of law, energy and opinions of individual lawyers such as Grotius or Blackstone; history which is not woven into the general fabric of society, random events which affect a powerful individual or produce a more general 'gut reaction.' All this means, of course, that to have any real understanding of a legal rule, its scope, purpose, utility and suitability, one must know its history. This in turn means that if we want to have a legal rule suited to our needs we must in many instances cleanse it from its history, take it right away from our existing tradition." Watson, *supra* note 5 at 132–133.

[132] *Ibid* at 110–111.

[133] Auyang notes that, ""Many causal factors pull and tug in all directions in a historical process, and the historian must compound them to find the movement of history… I need not explain why it is hopeless

Stephen Heim noted that even during the 1990s when the legal systems of the post-Communist world were being changed en masse, and where transplants were a predominant type of legal reform, there was concern about the practical limits of existing theory when used to look forward in time:

> Predicting when a legal change is going to occur and when a legal transplant might be included as part of that change is difficult… scholars have been forced to rely on past events to demonstrate the validity of their legal transplant models and theories. As a consequence of this outcome-determinative method, comparative evaluations of the various legal transplant theories have been difficult because each scholar can single out past events, which confirm their theory and discredit competing propositions.[134]

A systems-based approach can help explain why predicting transplant outcomes is so difficult. To predict a system's behaviour with accuracy requires complete information about all of a system's constituents and their interactions through time, the potential variability of which could be enormous.[135] Describing how and where numbers of individuals and institutions interact at any given moment, while being each variably subject to an array of external contextual factors and internal normative perspectives, is difficult enough, but becomes exponentially more difficult when the scale of analysis or size of system being studied increases. Causal expectations about legal change are still possible, of course, but must be treated cautiously. In the past, legal transplant theorists have periodically offered dubious causal explanations couched in terms of perpetual or universal rules determining consistent outcomes, such as Kahn-Freund, who once claimed that the more "de-coupled" a law is from its social roots the more viable it will be as a transplant.[136]

What makes such types of predictive claims unsuitable for systems approaches, however, is that they remove any consideration of the vagaries of human decision-

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to find general hypotheses for aggregating the microcauses in historical systems, which are far more complex and heterogeneous. That is why historians cannot predict. They can assess the relative importance of various factors and decide what to include as the major causes in their accounts only because they are helped by hindsight." Auyang, *supra* note 82 at 331–332.

134 Heim, *supra* note 30 at 190.

135 Auyang, *supra* note 82 at 265.

136 Kahn-Freund, *supra* note 29 at 6.

making.[137] Humans, and institutions run by humans, make decisions based on subjective impressions of the present, with an awareness of the past, amid uncertainty about the future. If legal transplants are understood as operating within legal-social systems driven by human or institutional decision-making, then complete predictability would require guaranteeing that actors will behave in particular ways at particular moments in the future. This requires knowing how individual actors perceive their worlds, what expectations they have of the behaviour of others, and precisely *what* within their context will determine what their preferences will be in all cases. Human behaviour is rarely so mechanical and this kind of prediction is possible only to a limited degree. Whether any given social or legal norm, transplanted or otherwise, impacts an individual's behaviour depends on that individual's interpretation of the norm's relative importance in his or her particular decision-making context, which can be highly variable.[138]

The point here is that at the time when any legal transplant is introduced to a receiving legal-social system it will only be possible to know to a very limited extent what its outcome will be or is likely to be. When such receiving environments are understood as being composed of interactive, interdependent and complex relationships between actors and institutions, it will rarely, if ever, be feasible to accurately calculate any of a system's possible future states given the indeterminateness of human behaviour. This implies that expectations of future transplant outcomes are only appropriate when accurate prediction is ruled out and replaced by more restrained efforts to map out *potential* future paths for a system to take. Prediction will instead consist of calculating systems' potential for change in terms of relative possibility given what is known about prevailing conditions. Models do not need to have absolutely predictive powers to be useful and can still be valuable if they can distinguish where significant variation in a system might occur as a result of a transplant, when change is more or less likely to occur, and what the relevance of such potential change would be to system structures.

None of this is particularly new to legal transplant scholarship. Roger Cotterrell, for instance, expressed concern about how difficult it is to describe, much less predict, legal

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[137] Ruhl, *supra* note 91 at 867.
[138] Bicchieri, *supra* note 117 at 56–57.

change in a complex social environment.[139] Considerably less common, however, are explanations for *why* law changes in the way that it does. To say that a transplanted law fails to take root in a receiving legal system because that system or society did not embrace the law, for example, only explains how an outcome was produced, but is not a satisfactory explanation for *why* it did so. A systems-based approach, however, can address why legal change happens because it invites questions about how internal relational structures either invite or resist change. Whether or not a system can be expected to change as a result of one or more events will depend on the relative potential for change that such events would pose to the structural factors that maintain the system's shape.[140] For a system to be capable of change, adaptation or evolution through time, it needs an internal structural capacity to generate variety among its constituents and their interactions with its external environment, as well as a system-wide ability to observe, interpret and make use of the information that such interactions feed back to it. Why change comes to a system can be answered in terms of the susceptibility of the control factors that preserve its shape to change. When those control factors are linked to actor behaviours, which in turn are linked to contextual influences on that behaviour, it becomes possible to evaluate a system's potential for change in terms of factors that maintain system stability and the amount of effort that would be required to upset them.[141] A systemic explanation of *why* a system changes, therefore, is rooted in the concept of the system's inability to maintain its fixed state in the face of a given change factor.

Three conclusions can be gleaned from this. First, given the enormous complexity and variety of legal systems, however construed, around the world, it is far more likely that any given outcome of a legal transplant process will be unique rather than a faithful replication of another process elsewhere. Furthermore, given the complexity of any given system, attempts to predict specific outcomes in one place based on case studies derived from elsewhere will likely be defeated by local variability. Finally, and most importantly,

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[139] Cotterrell, *supra* note 36 at 79.
[140] Ryan, *supra* note 84 at p.109.
[141] Auyang, *supra* note 82 at 240. Berkowitz, Pistor and Richards implicitly understood the importance of this balance in their theory about the "health" of a legal system. A legal system was "healthy" if it was able to maintain its "legality" while striking a sustainable balance between innovation and preservation, stability and instability. Berkowitz, Pistor & Richard, *supra* note 52.

in spite of this massive range of possibility, shifting attention to 'context' and structural relationships within a system allows for claims to be made about potential transplant outcomes based on understanding what sorts of change are more or less likely than others to occur and why.

'Success' and Plurality

It is an extremely common for transplant literature to speak of the "success" or "failure" of particular transplant processes or of legal transplantation as a type of legal reform as a whole. "Success," however, is conceptually problematic because of its inherent subjectivity. Whether a transplant is 'successful' or not very much depends on who is asking the question and why, and how he or she imagines what 'success' is. For those who find success in the faithful replication of international "best practice" norms around the world, for instance, success would most likely look like something very close to a strict reading of the "transplant" metaphor, i.e. an unadulterated transfer.[142] In contrast, others might look determine a transplant's 'success' by gauging its ability to achieve a desired legal or social change, which would make fidelity to the form of the original law important only insofar as it is a means to that end. Such a perspective would be more tolerant of variability and modification of the transplant to suit 'context.' In further contrast, for those whose primary interest is the 'health' or 'legality' of a legal system, like Berkowitz, Pistor and Richard, 'success' would rest on the deeper question of whether a transplant's acceptance, rejection or modification reflected a deliberate response by a healthy, mature, self-aware legal system.

There is some danger, however that when choosing how to determine whether a

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[142] Such an approach is ubiquitous around the world, particularly among international agencies. To name only a very diverse few: the International Labour Organization (ILO), for instance, provides services to member states that includes "technical advice based on international labour law and comparative labour law best practices." "Labour Law," online International Labour Organization at: <http://www.ilo.org/ifpdial/areas-of-work/labour-law/lang—en/index.htm>. Interpol has published a brief guide on "'Best Practices' in Combatting Terrorism." "'Best Practices' in Combatting Terrorism," online, Interpol at: <https://www.un.org/en/sc/ctc/docs/bestprac-interpol.pdf>; the Competition Committee of the Organization for Economic Co-operation and Development (OECD) regularly publishes "Recommendations and Best Practices on Competition Law and Policy" reports which it claims "are often catalysts for major change by governments." "Recommendations and Best Practices on Competition Law and Policy," online: OECD <http://www.oecd.org/daf/competition/recommendations.htm>.

transplant process is 'successful', an observer might artificially breathing normative life into what is being observed when he or she explains what caused 'success' or 'failure'. Just because a transplanted law survives a transplant process and is adopted, accepted and incorporated formally into a given legal system should not automatically imply any inherent positive quality of the law or norm that makes it 'successful' or 'transplantable,' or that could guarantee a similar outcome elsewhere. Claims that certain laws, rules or norms are preferable for transplantation because they are more 'successful' or universally better somehow are methodologically problematic because they distract from the profoundly contextual and highly variable nature of legal systems and the subjective construction of "success" to begin with. In so doing, they avoid more serious questions about why legal change happens at all. Explanations, such as that offered by Pierre Legrand, where "society" is a kind of divine engineer that fashions law to suit the cultural contours of a society, are not adequate or realistic explanations of how or why law changes in the way that it does. There are no guarantees that the forces affecting a transplant will be driven by constant, inherent proclivities towards an objective, single type of 'success,' nor that any given law will always generate universally acknowledged optimal outcomes in every context into which it is introduced.[143]

If a legal system is understood as something that does not behave mechanically, and if one accepts that "success" is a relative and subjective concept that is reflected in the aims and interests of either the observer or of the actors or institutions under study, then any attempt to describe 'success' will have to contend with a plurality of perspectives and judgments about change. This difficulty should be familiar for legal pluralists. As Brian Tamanaha explains, acknowledging pluralism often comes hand in hand with recognizing the subjectivity of legal experience, allowing for disagreements about the underlying nature of law and abandoning the luxury of certainty that is offered by monist perspectives on law.[144] Similarly, analysts of transplant processes will always be faced with a choice. They may approach their analysis along the lines of an explicit perspective subjectively determined either by themselves or by one or more of their subjects, or they

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[143] Auyang, *supra* note 82 at 148.

[144] Brian Z Tamanaha, "A Non-Essentialist Version of Legal Pluralism" (2000) 27:2 JL Law & Soc'y 296 at 297.

may attempt to explore and explain the complexity of the phenomenon as a whole in terms of a plurality of normative perspectives, without committing to any unique vision for 'success.'[145] Neither is superior to the other, but it is important to understand that the nature of their explanations are quite different.

Conclusion

The premise of this chapter is that a 'systems'-based methodological approach would be appropriate for the study of legal transplantation because it is well suited to tackling many of its complex dynamics. For a systems-based approach to work, however, the vernacular and positivist understanding of a "legal system" as a hierarchical framework of norms or rules linked to state authority should be exchanged for a more open and flexible notion inspired from systems theories in the sciences. In the latter sense, a 'system' is an analytical tool for studying interconnected, interdependent network structures. Systems in this sense are not tied to any specific normative or other framework, and are capable of wide, flexible application. It is a relevant approach to take because it was originally designed to study natural phenomena that share the complexity inherent to the legal-social structures that legal transplant theorists have been challenged with understanding for at least the past fifty years.

While the complexity of reality may have fragmented legal transplant scholarship over the years, this paper proposes that it can be used to restore some unity to the field. A methodological approach based on systems theory offers a means to address some of the thornier issues that have divided and challenged transplant scholars for years. It also provides a means to link micro-level individual and institutional behaviours to macro-level systemic phenomena, allowing one to avoid the general-specific trade-off that currently makes grand theory approaches relatively inadequate for specific case studies, and vice versa. It also supplies a very tangible way of incorporating 'context' into analyses of how and why legal change happens within complex, interconnected and networked legal and social structures. Finally, by acknowledging the multiplicity of participants, systems analysis can offer a nuanced understanding of what 'success' means

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[145] Phelan, *supra* note 81.

for legal transplants, as well as grounded basis for understanding the extent to which anyone can make predictions about future transplant outcomes.

The chapter that follows will propose a general theoretical strategy for creating a conceptual methodological approach. Such an approach will aim to provide an impetus to re-assemble this fragmented field of study with an alternative means of thinking about how one can account for the enormous complexity that is inherent to legal transplantation in a way that is both sensible and practical. Rather than seeing the current plurality of theoretical models available for explaining legal transplants as an incommensurable debate about different truths, such an approach will unite them as collaborative offerings of the same phenomenon.

CHAPTER 3

A Systems-Based Approach to Domestic Reform Inspired by External Models

Introduction

This chapter will build on the previous ones by offering a strategy for a systems-based modelling approach that might bring some cohesion to the prevailing fragmented scholarly discussions about legal transplantation. Chapter 2 demonstrated how any legal transplant study will require one to make a number of methodological and epistemological choices that fit one's analytical ambitions. Decisions about things ranging from what a transplant "is," what law's relationship to society is, how one conceives of "success," etc., will all impact one's framework of analysis. Adopting a systems perspective is such a decision, and is one that requires a number of corollary epistemological and methodological choices to be made in controversial areas that have dogged the transplant debate for years. The section that follows will make explicit these implied choices. Once articulated, they will pave the way for a full exposition of a new systems-based methodological strategy in the remainder of the chapter.

Models vs. Metaphors

Up until this point, this thesis has employed the "legal transplant" as a terminological anchor simply out of convenience because it is so prevalent in the literature. Terminological clarity and precision is important, however, and as David Nelken once observed, any creative choice of a descriptive metaphor will bring with it its own implied normative assumptions and predictive presumptions about what law is and how legal reform happens.[146] Retaining a term simply because it is an industry standard therefore

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[146] With regard to legal transplant metaphors, Nelken differentiates between what he calls the "mechanical" metaphors of legal transfer ("export and import", "circulation", borrowing', diffusion' and "imposition"), which he says "reflect visions of law as a working institution, as an instrument and as a technique of social engineering," versus "organic" metaphors ("grafts", "viruses",

may be insufficient justification for having to accept the assumptions that come with it.

Whatever term one chooses to speak about this type of legal reform will have to be variable enough to allow for ready application in many contexts, but also descriptive enough not to be mistaken for pure metaphor. 'Legal transplant' is useful, but its medical or horticultural imagery is misleadingly suggestive and can cause confusion because it presumes a particular endpoint, i.e. that a transplanted norm, rule or law must either integrate perfectly in its new home or be rejected and die.[147] A more generic term, like 'legal transfers,' for instance, could be adopted in its place.[148] Yet, like 'legal transplant,' 'legal transfer' is subtly suggestive that law can 'leave' one place and 'arrive' somewhere else. It would be more accurate to describe foreign laws as being copied or imitated domestically instead. 'Legal replication,' or 'imitation' therefore, might be better, yet they too suffer from normative presumptions of desired copied end states, and therefore are no less problematic than 'transplants.' Esin Örücü's once suggested "legal transposition" as an alternative, describing the adaptation of a foreign law to suit a domestic context,[149] but it too suffers from being overly suggestive that such adaptation will in all cases be necessary, which may not be true.

This paper will assume that there is no single expression that is accurate and flexible enough to capture all outcomes and will abandon neat metaphorical terminology altogether. Instead, it will refer to the phenomenon for what it is, namely: "domestic legal reform inspired by external models." Although it lacks poetic charm, this clunky alternative compensates by making no presumptions about any end state or content. At most, it can be criticized for suggesting that law will always change or become reformed as a result of an externally inspired process, but this is well compensated for by its lack of

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"contamination", and "transplants") which "forms part of a functionalist vision of law as an interdependent part of a larger whole", vs. "discursive" metaphors ("translation", "transposition"), which "approach law as "'culture', 'communication', 'narrative' and 'myth'". Nelken, *supra* note 38 at 16.

147 Teubner called this a "false dichotomy." Teubner *supra* note 15 at 12.

148 John Gillespie uses this term, specifically to mean "the globalisation of norms, standards, principles and rules that regulate (shape the behaviour) of the object of the transfer. For example, it may be that businesses are targeted by a particular legal transfer. The term encompasses not only written laws and doctrines, but also spoken and sub-verbal communication." Gillespie, *supra* note 74 at 1.

149 Esin Örücü, "Law as Transposition" (2002) 51:02 ICLQ 205 at 207. Örücü writes that: "[e]ach legal institution or rule introduced is used in the system of the recipient, as it was in the system of the model, the transposition occurring to suit the particular socio-legal culture and needs of the recipient."

commitment to any particular material, procedural or systemic input or outcome. From this point forward, therefore, this paper will refer to the phenomenon in this fashion. Any mention of "legal transplants" from here on will be used only in reference to the concept as reflected in the work of "legal transplant" scholars.

Law, Society, Boundaries and Locating "Context"

This paper will make no presumptions of its own of how to define 'law' or 'society' or how they interact because it is not necessary to do so. Rather, what is important is being able to understand how they affect legal reform processes. Thus, instead of trying to locate legal transplants within abstract conceptions of 'law' and/or 'society', the aim here will be instead to explain legal reform processes in terms of systemic relationships that are informed and influenced by both formal legal and societal 'context.' Doing so makes it no longer necessary to fit transplants within nebulous definitions of 'law' and 'society', thereby freeing one to tailor system boundaries scale to suit what is being studied, whether tightly focused, or something as inclusive as 'anything related to legal reform.' However, doing so also requires discarding predictions of transplant outcomes, that are based on beliefs of specific determinative law-society relationships, as provided by some scholars in Chapter 1, as well as any axioms of law having any inherent transplantability characteristic connected to its socio-cultural relevance or 'fit'. The 'system' in such an approach will always be first and foremost a synthetic construct and *sui generis* to the observer's perspective, which need not be strictly correlative to any formal procedural system directing legal reform that may exist.

Indicators of Time and Change

A systems approach that focuses on interactive relations between actors and institutions within a 'system' will measure change in terms of events occurring over time caused by individuals or institutions who act after undertaking some idiosyncratic decision-making process. Although such decisions to act may be locked in time as specific events, the legal system itself will never be fixed in time because it emerges from ever-changing, dynamic relationships between individuals and institutions at different scales. Even a seemingly fixed feature of a legal system like legislation can have a fluid

character because the manner in which it is acted upon by system actors may change over time. However, discerning exactly when legal reform processes begin or end in such fluid systems may be difficult. A fixed event like the formal enactment of a proposed piece of transplanted legislation, for instance, while possibly ending a process of transplant selection, may also mark the beginning of further fundamental systemic change processes that the transplant may later cause, as Teubner's "irritant" thesis proposes. Thus, descriptions of change caused by transplants must contain both accounts of system actor behaviour as well as analyses of changes in the relationship dynamics and networked architecture of legal systems within which those actors operate. Finally, given the sheer complexity of these system structures and the variability of actor behaviours, descriptions of the future cannot be made in terms of precise, fixed events occurring at specific moments. Rather, predictions of the future must be limited to calculations of the possibility and probability that a system might experience changes in its behavioural and structural patterns in response to external stimuli, like the promulgation of a new law.

'Success' Revisited

If a legal reform process is described in terms of the aggregate and variable behaviours of actors within a legal system, then conclusions about what constitutes "success" would have to take into account the variety of conclusions of what it means for those actors. For a legal historian like Alan Watson, a legal transplant was "successful" if it survived journeys across borders and cultures, was adopted and integrated into the legal culture of the receiving host, and persisted through time.[150] For Pierre Legrand, the bar of "success" was considerably higher, with transplants "failing" whenever their content was modified by a receiving, local socio-cultural context.[151] Others have argued the opposite, that the alteration of a transplanted norm by a receiving environment is actually "a good indicator that a transplanted law has taken hold,"[152] while still others question whether it is even possible to objectively define "success" at all.[153] Rather than provide its own

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[150] Watson, *supra* note 1 at 30.
[151] Legrand, *supra* note 18 at 116–117.
[152] Pistor, Keinan, Kleinheiste & West, *supra* note 40 at 870.
[153] David Nelken cautions that it is easy to be seduced by the need choose criteria of "success" in order to prove, rather than evaluate, the validity of an argument, such that "ambiguity over the meaning of

objective definition, this paper will consider "success" a relative matter of perspective that varies with the viewpoints and interests of legal reform participants or observers. In this way, "success" is understood here as a variable judgment metric that is dependant on context as interpreted by system actors. Any definition of success, therefore, requires a preceding answer to the question: "success for whom?"

General Concept of a Systems Approach

This paper proposes a systems-based approach that explains macro phenomena in a legal system in terms of micro-level individual and institutional behaviours. It will employ a multi-layered analysis that is capable of identifying the contextual factors that influence micro-level behaviours and will explain how these behaviours aggregate into broader collective forces that give a system its macro shape.[154] Given the complexity of legal systems, the objective of an analytical framework like this will never be to elicit every single detail about a system, but rather to describe the gross features of its structures and their interactions with its external environment.

Multi-Layer Analysis

This paper proposes a three-layered analytical framework for studying legal reform processes inspired by external models. It consists of a **micro-level** (individuals and institutions), an intermediate **mezzo-level** (collectives or communities) and finally a **macro-level** (system). Such an approach presumes that explanations of institutional and individual behaviours at the micro-level cannot be used directly to explain macro-

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success regularly leads to the slaying of straw men." "Success," therefore, can look very different for different actors, which then begs the "fundamental question from which there is no escape is who gets to determine what is meant by success." David Nelken, "The Meaning of Success in Transnational Legal Transfers" (2001) 19 Windsor YB Access Just 349 at 352, 363.

154 This sort of multi-level analysis is common in other fields, such as economics, which distinguishes between the study of individual firm and household behaviours (microeconomics) and the study of aggregate variables affecting the economy as a whole (macroeconomics). Sunny Auyang distinguishes the two in such a way where "microeconomics inherits the 'invisible hand' and portrays a utopian economy in which the market coordinates the desires of individuals with perfect efficiency. Macroeconomics inherits the 'dismal science' and depicts an economy plagued by periodic recession and inflation. How does the perfect coordination at the microlevel lead to bungled-up macrophenomena? Does the schizophrenic relation between microeconomics and macroeconomics indicate the presence of emergent phenomena?" Auyang, *supra* note 82 at 203. Similarly, in evolutionary studies, macro-phenomena, like the origins of a new species, can be explained in terms of micro-level gene variation and natural selection processes. See Mitchell, *supra* note 95 at 83.

systemic phenomena because the causal link will be too tenuous or not evident. The two must therefore be linked through an intermediary stage, where micro-processes are aggregated into collective formations with sufficient substance to impart an effect on the macro-system.[155]

Micro-Level Analysis

The micro level seeks to understand individual and institutional behaviours, and looks to forms of their interaction and the manner in which they make choices to explain how and why legal change happens. It is at this level that "context" comes into play by affecting individual and institutional behaviour in ways that can determine legal reform outcomes. Descriptions of a legal reform process at this level will seek out and explain phenomena such as: why certain policy choices are made; why certain foreign legal models are chosen over others; why certain models or ideas appeal to different actors in certain ways within the legal system; why and how legal reform initiatives are acted upon by these actors, etc. Actors at the micro-level will vary depending on what system is being studied, but could include, for example: lawyers, politicians, academics, bureaucrats, judges, government departments and ministries, lobby groups, etc.[156]

Explanations of why individuals or institutions at the micro-level behave the way they do can be derived from understanding the networked environments they inhabit and how "context" affects their decision-making behaviour. A number of the authors surveyed in Chapter 1 are very interested in micro-level behaviour, and several characterized it in terms of rational decision-making. Alan Watson, for instance, described the behaviour of a judge seeking legal solutions to "actual cases" outside his or her own legal system as a rational decision made while searching for an optimal outcome.[157] Rodolfo Sacco was

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[155] This approach should not be confused with Julia Black's similarly layered "decentered analysis" of regulatory regimes. Where Black differentiates micro, mezzo and macro types of governance in order to shift attention away from the state, the analytical approach offered here instead uses three levels to distinguish different types of system properties and to explain system cohesiveness. Julia Black, "Decentring Regulation: Understanding the Role of Regulation and Self Regulation in a 'Post-Regulatory' World" (2001) 54 Curr Leg Probs 103.

[156] Institutions are, of course, complex entities composed of individuals and sub-institutions in their own right, of course. Depending on the scale of analysis, it may be entirely appropriate in some studies to treat an institution as an individual actor, while not in others.

[157] Watson, *supra* note 1 at 114.

interested in how external factors influence individual choice, and argued that concepts of "prestige" or the imposition of force affect it.[158] However, individuals do not often undertake decision-making in a vacuum, isolated from their peers or from society around them. Thomas Schelling has argued that people working in any interactive, networked environment make choices about what actions to take in response to "an environment that consists of other people responding to their environment, which consists of people responding to an environment of people's responses."[159] Giuseppe Monateri described this networked responsiveness in his study of how German legal theory became a predominant feature of Italian legal culture because of the attraction of 19th Century Italian legal intellectuals to German academic scholarship on Roman law.[160] This intellectual orientation of the Italian academy had a ricochet effect, inspiring Italian judges and jurists to imitate and incorporate similar ideas and styles into their own work, collectively shifting the legal system as a whole towards this new theoretical orientation over time.[161]

This type of decision-making can be approached using game theory principles, which can be usefully employed at the micro-level to understand actor behaviour as decision-making in pursuit of payoffs in networked, social environments. Game theory simplifies the study of behaviour down to examining the rationales that cause or lead actors to make the choices that they do, but when applied to systems theory, it powerfully shifts the source of dynamism and agency behind change away from the system itself and down to choices made by individuals. It also importantly provides a methodological link between a system and 'context, where 'context' becomes the lens through which micro-level actors construct their decision-making rationality as well as whatever external and internal influences direct their choices.[162] However, because actors in a legal system are imbued with their own variable intentions, value judgments and incentive calculations, it will rarely, if ever, be possible to characterize a legal system with any single type of payoff-seeking decision-making calculation, and therefore must contend with micro-level

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158 Sacco, *supra* note 43 at 398.
159 Schelling, *supra* note 93 at 14.
160 Monateri, *supra* note 44.
161 *Ibid* at 588–590.
162 Mitchell, *supra* note 95 at 221.

variability.[163] Although variability has been an obstacle that transplant scholars have persistently struggled with, it can be accommodated at the micro-level by seeking out and identifying aggregate patterns or trends of individual behaviour, which can be analyzed at the subsequent mezzo-level. Thus, to repeat an earlier example, while such an approach might appreciate the pursuit of 'efficiency' as an aggregate behavioural trait of a number of actors in a legal system, it would never see 'efficiency' as a single, dominant 'force' determining all actor behaviours, because such homogeneity would be highly unlikely.[164]

In summary, the micro-level analysis consists of trying to understand the contextual nature of decision-making by individual actors or institutions in a legal system. When these behaviours are aggregated into patterns or trends of behaviour, analysis turns to the intermediate, mezzo-level to understand how they impact the system as a whole and also return as contextual feedback to the micro-level.

Mezzo-Level Analysis

The intermediate, mezzo level bridges the micro (individual) and the macro (system) levels through the study of aggregated patterns of mass individual behaviours from which collective system properties emerge. Interaction among micro-level actors create network groupings that produce collective trends that sometimes may not be visible or evident at the individual level nor reflective of the macro system.[165] These collective groupings of behavioural patterns, when combined with others and taken as a whole are the basis upon which the macro level properties of a system as a whole can be determined. Flows of information through a system are also visible at the mezzo level, as mass patterns of individual behaviour feed back to the micro-level when micro level system constituents recognize collective behavioural phenomena as contextual considerations for their decision-making. Whereas the micro level looked to *how* and *why* individuals within the system behave, the mezzo level looks instead to what the *effect* that collective behaviour has.

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[163] Schelling notes that, "[w]ith people, we can get carried away with our image of goal seeking and problem solving. We can forget that people pursue misguided goals or don't know their goals, and that they can enjoy or suffer subconscious processes that deceive them about their goals." Schelling, *supra* note 93 at 18.

[164] Rasmusen, *supra* note 118 at 18.

[165] Auyang, *supra* note 82 at 154.

Alan Watson provided an example of the challenges of analyzing systems at this intermediate, mezzo level. Watson believed that the "parameters of legal thinking" of "legal communities" within a legal system played a greater than normally acknowledged role in determining doctrinal developments at large. He struggled, however, with accounting coherently for any universal or consistent criteria for what such 'parameters' might that fit all case studies. The best he could come up with was that they were the "shared social, political and economic values and conditions," with which legal communities seek out legal concepts or laws from abroad. This was unsatisfactorily vague and impossibly variable across case studies for Watson, so he abandoned his search for any universal criteria and resigned himself instead to a claim that the only thing generalizable across cases was that transplantation always required a foreign law to be "accessible" to a borrowing legal community by being in writing, easy to find and understand, and readily available.[166]

One way of explaining Watson's frustration with this methodological problem is that he was not able to describe how a group of interacting individuals and institutions could collectively determine which foreign models should be selected for transplantation over others. The multi-layered approach presented here offers a means to address his challenge by descending into a micro-level analysis to understand the decision-making rationales of the members of those legal communities, and then looking for mezzo-level aggregate patterns of that behaviour within that community that generate aggregate impressions of the collective, which in turn could feed back and influence the selection of any given law by key decision-makers. While Watson struggled to explain how the 'community' itself made decisions about what laws to borrow, a multi-layered approach would instead ask what criteria are used by individuals in positions of power when making their decisions, and how they may or may not be impressed by mezzo-level impressions of community behaviours to guide them.

Monateri's study of German influences in the Italian legal system noted earlier is another example of a mezzo-level analysis that succeeds in explaining change and communal selection at the mezzo level where Watson could not. According to Monateri,

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[166] Watson, *supra* note 1 at 112–113.

behaviours of large numbers of predominant Italian academics in the 19th Century gave a collective impression to their Italian jurist peers that Germanic legal theory and style were worth imitating. When enough jurists began to imitate (micro level) the collective behaviour of their academic colleagues (mezzo level), they created a wider mass effect on the entire legal system as the behaviours of both communities solidified over time (mezzo level), thereby giving the Italian system an overall character (macro level) of having a German philosophical base despite the French origins of its initial codification.[167]

Patterns of systemic equilibrium dynamics are first observable at the mezzo level. A mezzo level analysis will look to whether aggregate patterns of micro level decision-making remain constant or fluctuate in response to information received from external forces and from mezzo level impressions. Patterns of equilibrium, where decision-making remains constant in the face of established flows of information coming from both the external environment and from mezzo-level system feedback, provide a powerful means to assess the potential for change within a system. Again using Monateri's example, an equilibrium analysis would ask why the mezzo impression from Italian academics as a collective was so convincing for Italian jurists at the time such that they collectively changed their decision-making patterns to synchronize with them, breaking or disregarding whatever prior behavioural equilibrium that had kept their behaviour constant until then.[168] Similarly, equilibrium patterns allow for assessments of system stability by asking whether or not sufficient numbers of actors within a system likely have enough incentive to change their behavioural patterns at any given moment. A system is stable when it has insufficient numbers of actors with incentives to change their behaviours, such that their aggregate, collective impression is one of stasis. This stasis

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[167] Monateri, *supra* note 44 at 588–590. Alan Watson explained this solidifying effect on community behaviour as "habit of practice," which could describe practices of legal communities of one system habitually returning to the same foreign legal system, such as Germany, as a "habitual quarry" to borrow rules for future development, which over time would reinforce behaviours further, such that the more that is borrowed from the "quarry" the more it becomes the "right thing to do." Watson, *supra* note 1 at 110–113.

[168] Monateri provides two reasons for this change in jurist behavioural traits. First, that legal academics taught jurists the German theory, which caused a generational change in the training of the jurist profession. Secondly, he argues that "because theory was the realm of intellectuals and law was essentially conceived as theory… the role of courts would have been to apply professors' theories to particular cases… the prestige of professors induced lawyers and judges to accept the role and to imitate their way of writing." Monateri, *supra* note 44 at 590.

can perpetuate itself by providing mezzo-level information about system stability to others at the micro level in the system that may or may not affect their payoff calculations. System instability, in contrast, exists where actors have sufficient individual incentives to change their behaviours in pursuit of payoffs, and do so in sufficient numbers to change collective, aggregate patterns of behaviour, thereby changing the context of micro level decision-making for other actors. In this sense, potential for change at the micro-level can affect the potential of a system overall to change, and can ultimately explain why legal reform processes turn out the way they do.

Macro-Level Analysis

Finally, the macro level analysis looks to how mezzo level collective trends or impressions contribute to the overall macro behaviour patterns of the system under study.[169] Macro system properties are understood to emerge from aggregated mezzo patterns of impressions that themselves emerge from the aggregated patterns of behaviours and relationships at the micro level. The effects of micro-level individual behaviours will often be too distant to be felt or directly observed at the macro level, so macro phenomena will not normally be described in terms of them, but rather linked to them through the mezzo level.[170] Monateri's depiction of the Italian legal system's predilection for German legal philosophy, for instance, is a macro-systemic characteristic that can be traced down to the mezzo-level impressions of aggregate general behavioural trends of communities of jurists and academics, and further still to particular micro-level imitative practices of members of both communities with feedback information flowing through and informing all these levels. It would have been insufficient, however, for Monateri to say only that the Italian legal system developed that tendency because 19th Century academics read a lot of German Roman law treatises. Although partially true, the causal link is simply too remote, and needs the mezzo level explanation of community behaviours to connect the two and explain why the entire system changed the way it did.

The momentum for change in a system is derived therefore from the collective behaviours of actors at the micro level and from impressions of communities of actors at

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[169] Auyang, *supra* note 82 at 154.
[170] *Ibid* at 176.

the mezzo level, all acting and interacting, following incentives and pursuing payoffs. Principles of equilibrium dynamics allow for limited predictions of future changes based on expectations of a system's change potential, where systems with weak equilibrium dynamics being more likely to experience change then those with strong ones. Beyond that, however, because the large-scale organization of a legal, or any other system, at the macro level can be highly complex, it can be very difficult to predict what emergent effects will arise at the macro level from changes made at the distant micro level, or how micro changes will feed back through the mezzo level to inspire further micro changes, creating further mezzo and macro level changes. This multi-layered approach appreciates how the complexity of this arrangement will make it difficult to predict what macro level effect the introduction of something like a new law could have on a legal system. The most it can offer as prediction would be an evaluation of the change potential of actors and their decision-making rationales at the micro level in response to the law, and of their relative capacity to do so in numbers sufficiently large to cause system-wide changes at the mezzo and macro levels.[171]

Conclusion

In Chapter 1, critics of the law and society paradigms of authors like Watson and Legrand struggled to explain how and why legal transplantation causes change in the complex, dynamic, interconnected and interdependent context of law's interaction with society. Drawing upon theories about systems taken largely from the sciences outlined in Chapter 2, this chapter has offered a multi-layered analytical tool to facilitate explanations of how and why legal reform processes inspired by external models sometimes cause systemic changes and sometimes do not. Its aim was to provide a framework and a vocabulary with which such processes and their effects could be described. It does not, however, offer any new revelations about law's relationship to society. It provides no new criteria of transplant 'success' or 'failure', no new typology of legal transplantation, and no new grand theory of law.

Rather, it is an invitation to map and characterize reality in terms of complex

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[171] *Ibid* at 175.

networks of relationships through which legal reform processes navigate. Such an approach gives individual actors and institutions key roles within a legal system, and draws attention away from the laws with which they work. Instead, it directs towards the decision-making behaviour of actors and their interactions with each other as the force that determines whether or not a legal system will experience change. In so doing, it discourages easy assumptions about system behaviour based on observations of the mere presence of particular laws or kinds of individuals, institutions or structures within a legal system, and requires any such observations to be supported with corollary statements about inter-dependent relationships and decision-making rationales of those actors. Decisions by micro-level actors to act upon a domestic legal reform inspired by an external model are therefore the ultimate determining factor of whether or not that reform will have any effect at all, and it provides a framework for explaining why legal systems undergoing reform can be said to be more or less likely to change in the future and in what ways. The strength of such an approach will be demonstrated in the following chapter, where a particular case study, that of banking in Afghanistan, will be subjected to a multi-layered analysis.

CHAPTER 4

Case Study – Afghanistan's Law of Banking

Introduction

The Afghan *Law of Banking* of 2003 is a paradigmatic 'legal transplant.' It was prepared largely by foreign advisors and promulgated quickly in the early years after the fall of the Taliban regime. It was expected to be a key feature of the new market economy that would undo nearly thirty years of Soviet-inspired centrally planned state policy and repair the damage done by two decades of fighting. This chapter will examine the regulatory regime that evolved out of the *Law of Banking* as a case study to test the utility of the multi-layered approach outlined in Chapter 3. Afghanistan may seem an unusual source from which to draw a case study to test this approach, but as a recipient of a great deal of 'transplant'-driven legal reform assistance over the past decade, it is actually a highly appropriate subject for this sort of study. Furthermore, the *Law on Banking* is a rich case study. It typifies the direct, cut-and-paste "legal transplant," yet, as will be seen, the evolution of the regulatory environment that it created was highly contextualized and idiosyncratic.

Doctrinal Background

By the time the Taliban regime fell in 2001, Afghanistan's financial and banking systems were wrecked shells of what they had once been, consisting of six licensed but non-functional state-owned banks that were unable to receive or protect deposits and had not issued a loan in years.[172] Afghans instead relied upon informal *hawala* dealers, the

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[172] Jelena Pavlovic & Joshua Charap, *Development of the Commercial Banking System in Afghanistan: Risks and Rewards,* IMF Working Paper WP/09/150 (Washington DC: International Monetary Fund, 2009) at 3, 7. The six licensed state owned commercial banks consisted of two commercial banks (Bank-e-Millie Afghan and Pashtany Tejaraty Bank), four special purpose development banks (the Agricultural Development Bank, the Export Promotion Bank, the Industrial Development Bank of

ancient, international network of money brokers that has operated throughout the Middle East, Asia and Africa for centuries, to service their financial needs.[173]

In 2002, the International Monetary Fund (IMF) took the lead role in restructuring Afghanistan's largely informal economy and its broken banking sector, and drafting new legislation was seen to be a key first step.[174] Any effort to rebuild Afghanistan's banking sector was bound to be challenging. The existing formal regulatory framework consisted of outdated, Soviet-inspired laws implemented by barely functional institutions with no telecommunications infrastructure, limited human resource capacity, and stiff competition from the informal sector.[175] The banking law in force at the time was the Soviet-inspired *Law on Money and Banking* from 1994, which set formal foundations for commercial banking but envisioned a centrally managed banking sector consisting of vertical, dirigiste structural relationships between the government, the central bank and state-owned commercial banks.[176] For the IMF, such a structure was completely inadequate to the task of building a market economy.[177]

Beyond the prevailing banking law, the basic legal architecture regulating secured and unsecured lending was provided by Afghanistan's Commercial and Civil Codes. The 1955 Commercial Code covers matters related to business organization, business transactions and contracts, and liability/damages with provisions dealing with the creation and enforcement of liens on property, commercial mortgages and procedures for

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Afghanistan, and the Mortgage and Construction Bank).

173 In 2001, the wide range of financial and nonfinancial business services offered by the Afghan *hawaladars* included: money exchange transactions, funds transfers, micro-finance, trade finance, and deposit taking, telephone and fax services, regional and international trade assistance, and some deposit-taking facilities, microfinance for informal entrepreneurs, trade finance for wholesalers and retailers, and currency exchange services. The efficiency of the informal network can be surprising for outsiders unfamiliar with its operations. Maimbo observed in 2003 that "transferring funds to Kabul from Peshawar, Dubai, and London usually takes 6 to 12 hours… the cost of making funds transfers into and around Afghanistan averages 1 to 2 percent. As is common with every bazaar in South Asia, however, the final quotation depends on the negotiating skills of both parties and their understanding of how the market operates… The *hawala* system is reliable. Dealers seldom fail to effect payment." Samuel Munzele Maimbo, *The Money Exchange Dealers of Kabul*, World Bank Working Paper 13 (Washington D.C.: The World Bank, 2003) at 3–5.

174 International Monetary Fund, *Islamic State of Afghanistan: Rebuilding a Macroeconomic Framework for Reconstruction and Growth*, IMF Country Report 03/299 (Washington D.C.: International Monetary Fund, 2003) at 91.

175 Maimbo, *supra* note 173 at 1.

176 International Monetary Fund, *supra* note 174 at 117.

177 *Ibid*.

the certification and registration of loans.[178] Complementing the Commercial Code is the 1976 Civil Code,[179] a virtual copy of the *Shari'ah*-inspired Egyptian Civil Code of 1948, which contains relatively few provisions relevant to banking, but sets the framework for general contract principles,[180] provisions for loans of money or goods,[181] and dispute resolution or "peace settlements".[182] Although not reflected in the Codes, further legal nuance may be provided by *Shari'ah* and customary law principles applied at the local level by businesses, communities and judges in court cases, private arbitration or traditional dispute resolution processes.[183]

In those early years, it was not certain at all how, or what kind of, legal reform Afghanistan needed in 2001. For the United States Agency for International Development (USAID), which assumed the lead on banking reform from the IMF in 2003, the overall legal framework was severely deficient for a modern banking system and needed to be completely overhauled. Afghanistan's existing commercial laws were incomprehensible for investors, could not be relied upon to provide a straightforward regime for security interests in property and were generally anathema to the needs of modern businesses.[184] The IMF, on the other hand, felt that other than the 1994 banking law, "the property law and the law of obligations could in principle be adequate for supporting banking

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178 Chapter IV (D), (E), (F) Commercial Code of Afghanistan (1955).

179 Bruce Etling, "Legal Authorities in the Afghan Legal System (1964-1079)" Harvard Islamic Legal Studies Program Afghan Legal History Project, online: <http://www.law.harvard.edu/programs/ilsp/research/etling.pdf> at 12.

180 Art. 492-578, 1035-74, 1097-1107, 1136-51, 1159-62 Civil Code of Afghanistan (1976).

181 Art. 1288-94, 1456-80, 1295 Civil Code of Afghanistan (1976).

182 Art. 1297-1320 Civil Code of Afghanistan (1976).

183 Sadly, it is beyond the scope of this paper to investigate this under-researched field in Afghanistan, and it is difficult to quantify the degree to which these influence actors at the micro level. One study has noted the incongruence of the codified law to traditional dispute resolution mechanisms in Afghanistan. See Nadjma Yassari and Mohammed Hamid Saboory, "Sharia and National Law in Afghanistan" in Jan Michiel Otto (ed.) *Sharia Incorporated: A Comparative Overview of Twelve Muslim Countries in Past and Present* (Amsterdam: Leiden University Press, 2010) at 273-318. The study of the interaction of Islamic law and western-inspired commercial law elsewhere in the Islamic world is significantly more robust, however. See for instance: Chibli Mallat, "Commercial Law in the Middle East: Between Classical Transactions and Modern Business," (2000) 48 Am J Comp Law 81; and Peri J. Bearman, Wolfhard Heinrichs, Bernard G. Weiss, *The Law Applied: Contextualizing the Islamic Shari'ah: A Volume in Honor of Frank E. Vogel* (London: I.B. Tauris, 2008).

184 Booz Allen Hamilton, *Afghanistan's Agenda For Action: Developing the Trade & Business Environment* (Washington D.C.: US. Agency for International Development (USAID), 2007) at 31, 34, 49. The strength of this report's aversion to the existing legal regime is palpable in its critique of Afghan Contract law: "[t]he tortured language of the existing Civil Code represents a national consensus in favor of forgiveness over enforcement, a sentiment that is essentially rejected by the new contract law that presumes to hold people to their obligations."

transactions in Afghanistan."[185] The country's legal framework at the time was mostly non-operational, it argued, not because of its content, but because its supporting institutions no longer existed, most significantly its non-functional bankruptcy regime, which needed: "record-keeping institutions, functioning courts and police, and an impartial and independent judicial system."[186] The existing legal framework, of course, made perfect sense to sitting Afghan commercial court judges that the author interviewed in 2010, who, unsurprisingly, felt that any such overhaul was unnecessary.[187]

Nevertheless, with the support of international advisors, a new *Law of Banking of Afghanistan*[188] was promulgated by presidential decree in 2003. It sets out rules and regulations for forming, licensing and operating private banks and outlines their supervisory relationship with the central bank, the *Da Afghanistan Bank* (DAB). The law and its associated regulations provide DAB with the exclusive power to license banks,[189] outline the basic regulatory requirements of authorized banking activities,[190] set standards for governance and administrative structures,[191] detail what are controlled or prohibited activities,[192] identify obligatory requirements for bank solvency,[193] auditing, and

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185 International Monetary Fund, *supra* note 174 at 119–120.

186 *Ibid*.

187 In the words of one judge, the commercial law did not need replacing because it was "good enough, and that "the Commercial Code with its several branches may be complicated, but that does not make it undesirable; if you open it and read it, it will be clear." Michael Leach, *Afghanistan's Commercial Law Sector - Past, Present and Future*, Deutsche Gesellschaft für Internationale Zusammenarbeit (2010) [unpublished] at 26.

188 *Law of Banking* online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/UpdatedOfBankingLaw.pdf>.

189 *Law of Banking,* Art. 2, 6; *Licensing Regulation*, online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/LicensingRegulation.pdf>.

190 *Law of Banking,* Art. 32-34.

191 *Law of Banking,* Art. 22-31; *Corporate Governance Regulation,* online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/CorporateGovernanceRegulationFinal.pdf>.

192 See *Prohibited and Authorized Activities Regulation,* online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/ProhibitedAndAuthorizedActivitiesRegulation.pdf>; *Qualifying Holdings Regulation*, online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/ControlRegulation.pdf>; *Credit Extended to Related Persons Regulation* online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/ControlRegulation.pdf>; *Asset Classifications, Monitoring of Problem Assets, Reserve for Losses, Non-Accrual Status Regulation*, online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/Classification_and_Loss_Reserve_Complete_Revision_circulated_for_internal_comment_rev_Aug_2006.pdf>; *Open Positions in Foreign Currencies Regulation,* online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/OpenFXRegulation.pdf> ; and *Asset Risk Diversification and Limitations on Large Exposures of Banking Organizations Regulation*, online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/Large_exposures_reg_draft_Revisions_sent_for_public_comment

reporting procedures,[194] as well as various internal prudential procedures for doing things like maintaining base capital and liquidity levels, and classifying and evaluating assets.[195] DAB enforcement powers under the law include the authority to warn banks of regulatory violations, to bring banks before delinquency hearings and issue orders for corrective action,[196] and, in extreme cases, revoke a bank's license,[197] seize control, and appoint a Conservator,[198] and either rehabilitate or liquidate it.[199] The *Law of Banking* also provides a comprehensive bankruptcy procedure[200] that is explicitly separate from bankruptcy provisions that exist elsewhere in Afghan law, and makes use of a new non-judicial arbitral authority created for this purpose, named the Financial Disputes Resolution Commission (FDRC).[201]

Timeline Narrative of Events

For the first year and a half after the end of the Taliban regime, the IMF advised the new transitional Afghan government on banking legislative reform.[202] Together with financial experts from an American non-profit agency called the Financial Services Volunteer Corps (FSVC),[203] it prepared early drafts of new banking legislation based on models drawn from previous examples of post-communist banking reform in Eastern Europe in the 1990s. The IMF's role was largely supplanted by USAID in 2003, when it

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193 *Law of Banking,* Art. 20; *Liquidity Regulation*, online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/liquidityRegulation.pdf>.

194 *Law of Banking,* Art. 42-45.

195 Art. 35 *Law of Banking*; *Capital Regulation*, online: Da Afghanistan Bank <http://www.centralbank.gov.af/pdf/CapitalRegulation_EN.pdf>.

196 *Law of Banking,* Art. 46-52.

197 *Law of Banking,* Art. 14.

198 *Law of Banking,* Art. 53-60.

199 *Law of Banking,* Art. 61-63.

200 *Law of Banking,* Arts. 64-96.

201 *Law of Banking,* Art. 64. Although established primarily to resolve regulatory disputes in the financial sector, it was not until the Kabul Bank crisis of 2010 that the FDRC was first used for this purpose. For the first few years of its life, although some banking-related cases came before it, much of the work of the FDRC was devoted to resolving regulatory disputes in the telecommunications sector instead. This was likely because the same USAID contractor that was assisting with banking regulation was also working in the telecommunications sector, and thus prepared legislation that gave this body jurisdiction over such matters.

202 Åke Lönnberg, *Building a Financial System in Afghanistan* (Bonn, 2003) at 17.

203 FSVC is an American non-profit institution that arranges pro bono financial sector consulting services to developing countries.

launched an enormous $98 million economic reconstruction program in Afghanistan through its "Sustainable Economic Policy and Institutional Reform Support Program" (SEPIRS). BearingPoint Inc., a multi-national management consulting firm, won the tender for the USAID project and during the subsequent decade placed a number of advisors within DAB, tasking them with finalizing the new banking laws and building DAB's capacity to regulate the banking sector thereafter. A new law based on the drafts prepared by the IMF was promulgated in September 2003.[204] It was purposefully designed to replicate international best practice models, attract investment and jump-start the (re)birth of a private banking industry in the country.[205] Over the ensuing decade, Afghanistan's banking sector expanded very quickly, from zero to sixteen foreign and domestic banks by 2009, with $805 million in circulating deposit capital.[206] By all accounts, in only a few years, Afghanistan had managed to grow a domestic, albeit imperfect, banking sector out of practically nothing, thereby quickly meeting the short-term objectives of the legislative reform project.

This inspiring picture was shattered in 2010 when media allegations emerged of improper lending and massive fraud at Kabul Bank, Afghanistan's largest private bank, and caused a major public scandal and economic crisis.[207] The independent public inquiry launched after the crisis reported that since its founding in 2004, the two main shareholders of Kabul Bank, Sherkhan Farnood and Khalilullah Ferozi, had used it to funnel depositor assets to fund the business ventures of themselves and their personal networks through interest-free loans to a complex web of shell companies.[208] DAB first became aware of "irregularities" at Kabul Bank, when the near collapse of the Dubai real estate market in 2009 caused a liquidity problem at the bank and speculation about its

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[204] It is not clear to what extent the resulting banking law was inspired by the IMF/FSVC draft law, however the speed in which it was developed suggests that it was at least inspired by it.

[205] At the time of the new law's promulgation, the DAB Governor announced that, "Banking is essential for a modern economy. It is one of the services investors need… Now we're going to allow banks fully- owned by foreigners and Afghans." Victoria Burnett, "Foreign Bank in Afghanistan", *Financial Times* (17 September 2003).

[206] Mohammad Elhage et al, *Islamic Republic of Afghanistan: Selected Issues*, IMF Country Report 08/71 (Washington D.C.: International Monetary Fund, 2008) at 14.

[207] Andrew Higgins, "In Afghanistan, Signs of Crony Capitalism", *Washington Post* (22 February 2010).

[208] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *Report of the Public Inquiry Into the Kabul Bank Crisis* (Kabul, Afghanistan, 2012) at 63 online at: <http://mec.af/files/knpir-final.pdf>.

investment losses.[209] Through 2010, as more details came to light of possible fraudulent lending and capital shortfalls at Kabul Bank, DAB responded by issuing demands that its management resign, all of which were rebuffed while a caustic struggle for power ensued between its two main shareholders. Eventually, DAB unilaterally seized control of the bank in late August through its powers under the *Law on Banking*.[210] News of this move, along with media revelations of hundreds of millions of dollars in losses, sparked a public panic and a run on the bank on September 1, 2010.[211]

What had been a bubbling scandal suddenly turned into a serious crisis of confidence that threatened to destabilize the economy. DAB issued a $350 million lender-of-last resort credit facility drawn from the national reserves on September 5, 2010 to guarantee deposits at the height of the public panic. When it was evident that the bank would be unable to repay this loan, DAB turned to the Financial Disputes Resolution Commission, specifically created years earlier to resolve bank disputes, and initiated bankruptcy proceedings against it.[212] Then, with IMF support, it moved to place the bank's 'bad' assets into receivership, created a new replacement bank with its remaining 'good' assets, called "New Kabul Bank," and placed it under the ownership and control of the Ministry of Finance, with the intention of eventually privatizing it to recover some of what had been lost.[213]

Although such actions quelled the immediate public panic, they did not dampen

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[209] Losses notwithstanding, Afghan banking regulations prohibited banks from making real estate investments locally or domestically. See *Prohibited and Authorized Activities Regulation*, *supra* note 191.

[210] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 44.

[211] Adam Ellick & Dexter Filkins, "Political Ties Shielded Bank in Afghanistan", *New York Times* (7 September 2010), online: <http://www.nytimes.com/2010/09/08/world/asia/08kabul.html?pagewanted=all>.

[212] DAB's authority to bring bankruptcy proceedings against Kabul Bank fell under Article 66(1) of the *Law of Banking*. The FDRC ruled that bankruptcy proceedings were legitimized under Article 65 of the *Law of Banking*, because Kabul Bank was unable to pay its financial obligations; under Article 65(1)(2) because its capital was less than 75% of that required by law; and under Article 65(1)(3) because its liabilities were more than the value of its assets. Financial Disputes Resolution Commission, *The Decision of Financial Disputes Resolution Commission on Opening Bankruptcy Proceedings Against Kabul Bank*, issued: 30 Hamal, 1390.

[213] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 54; Joshua Partlow, "IMF Wants Afghanistan's Troubled Kabul Bank Sold Off", *Washington Post* (16 February 2011), online: <http://www.washingtonpost.com/wp-dyn/content/article/2011/02/16/AR2011021604163.html>.

domestic and international outrage over the $1 billion that the bank had lost,[214] or the allegations of connections between the bank and Afghanistan's political elite, or of obvious efforts by the Government to stymie any public investigation or prosecution of its main culprits.[215] While the crisis did not bring down the economy, it did reveal serious weaknesses in the banking regime and corruption in the Government, and put into doubt much of the investment made in the banking sector and the economy as a whole over the past decade. Under tremendous pressure from donors, the Government eventually launched investigations and a public inquiry, but it also banned indefinitely all U.S. advisors from DAB, which effectively terminated USAID's large support project there.[216] The space was partially filled by the IMF, which allocated some funding and attention to building DABs' supervisory capacity and revising a new banking law, a project that is ongoing. For reasons that will be discussed in the multi-layered analysis that follows, responses to the crisis, despite its seriousness, have not, and likely will not resolve many of the structural weaknesses that continue to plague the sector.

Micro-Level Analysis

As stated in Chapter 3, micro-level analysis explains relevant individual and institutional behaviours within the relational context in which they occur in terms of decision-making rationales of actors.

For this limited case study, the following micro-level agents are considered relevant to Afghanistan's banking system:[217]

* The International Monetary Fund (IMF)
* The United States Agency for International Development (USAID)

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[214] Alissa J Rubin & James Risen, "Losses at Afghan Bank could be $900 Million", *New York Times* (30 January 2011), online: <http://www.nytimes.com/2011/01/31/world/asia/31kabul.html>.

[215] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 56.

[216] Special Inspector General for Afghanistan Reconstruction, *Afghanistan's Banking Sector: The Central Bank's Capacity to Regulate Commercial Banks Remains Weak*, Audit Report SIGAR 14-16 (Arlington, Virginia: Office of the Special Inspector General for Afghanistan Reconstruction, 2014) at 5–6.

[217] Although more actors could be included, providing ever more detail about the system at hand, these are enough to establish determinative causal mechanisms that produced the system outcomes identified in the narrative earlier.

* BearingPoint Inc./ Deloitte
* The Central Bank of Afghanistan - *Da Afghanistan Bank* (DAB)
* Domestic and foreign banks
* Bank consumers (depositors)
* Bank consumers (borrowers)

Each will be reviewed separately below. Although there is some risk of confusion as each overlaps on the timeline of events, this nevertheless reflects the heterogeneous and confusing nature of the throng of concurrent activity at the micro-level.

Micro - International Monetary Fund (IMF)

In 2001, the IMF advised the new government to make swift changes to its banking legislation because it was of the opinion that, "the speed with which Afghanistan's economy can be rebuilt and sustainable economic growth achieved, and ultimately widespread poverty reduced will depend crucially on a rapid and sound redevelopment of its financial sector."[218] This position was justified based on research findings[219] and a decade of experience in reconstructing financial systems in countries transitioning from Communism.[220] It believed that sustainable economic growth and job creation should be brought about by private-sector-led growth, rather than by government or donor

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[218] International Monetary Fund, *supra* note 174 at 116.

[219] Ross Levine, Norman Loayza & Thorsten Beck, "Financial Intermediation and Growth: Causality and Causes" (2000) 46 J Monet Econ 31; Paul Holden & Vassili Prokopenko, *Financial Development and Poverty Alleviation: Issues and Policy Implications for Developing and Transition Countries*, IMF Working Paper 01/160 (Washington D.C.: International Monetary Fund, 2001).

[220] In a 2003 report the IMF claimed that: "for the government to pay the wages of its civil servants, procure goods and services, and undertake investment in infrastructure, for it to collect taxes and customs duties efficiently and for Afghanistan to make the best use of the substantial donor funds destined for its reconstruction, a rudimentary payment system and basic financial services are essential. It is thus paramount for the Afghani [sic] authorities to quickly initiate reforms to move away from cash as the sole medium of exchange and to lay down the enabling framework for an efficient commercial banking system to flourish. And for all this to be done while safeguarding against fraud and bank failure, it will be necessary to rebuild a modern central bank, with a supervisory capacity in line with international standards to oversee the operations of the new banking system as it develops." International Monetary Fund, *supra* note 174 at 116. Lewarne and Snelbecker argue that it was because of reconstruction efforts in the Balkans in the 1990s that the IMF had "learned enough to act immediately… to start economic governance institutions more rapidly." Stephen Lewarne & David Snelbecker, *Economic Governance in War Torn Economies: Lessons Learned from the Marshall Plan to the Reconstruction of Iraq* (Carlsbad, CA: The Services Group, 2004) at 21.

spending, and that macro-economic legal reform had to be introduced early to encourage it.[221] It summarized its vision for the banking sector as follows:

> The early enactment of a modern central bank and banking law will be crucial for the development of a sound and resilient private banking sector and more generally for macroeconomic stability and growth in Afghanistan. The laws will also be crucial if foreign banks, with their much-needed technology and management know-how, are to be attracted into Afghanistan… It is therefore very important that potential investors are given transparent, predictable, and sound 'rules of the game.' At the same time, the central bank needs to have the proper tools to regulate and supervise the banking system without government and political interference. This would help to restore the confidence of the public in the banking system and serve to regenerate the deposit base that banks need to be able to extend credit.[222]

The IMF prepared an early draft of a new banking law, largely compiled from post-communist models, whose key features were: licensing, base capital requirements and viable business plans; a devotion to commercial banking, with restrictions placed on state ownership of banks; the central bank as the core regulator; international standards for prudential rules and regulations; and finally bank transparency based on reporting and disclosure to the market.[223]

When USAID launched its massive SEPIRS economic governance program in 2003, the IMF stepped away from active involvement in building the banking sector.[224] Until 2010, its work was limited to periodically reporting on banking in Afghanistan and managing an Extended Credit Facility (ECF) program to assist the Afghan Government with "maintaining macro-stability and promoting reform".[225] The international community in Afghanistan paid close attention to the IMF's scrutiny of the Afghan economy, using its pronouncements on its health as a yardstick to calculate the viability of their own aid commitments.[226] The majority of its reports were cautiously optimistic,

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221 Lewarne & Snelbecker, *supra* note 220 at 29, 35.
222 International Monetary Fund, *supra* note 174 at 130.
223 Lönnberg, *supra* note 201 at 12, 17–18.
224 *Ibid* at 12.
225 International Monetary Fund, *Islamic Republic of Afghanistan - Current IMF-Supported Program*, Program Note (Kabul, Afghanistan: International Monetary Fund, 2013) at 2.
226 Alissa J Rubin, "I.M.F. Said to Have Harsh Assessment of Troubled Kabul Bank", *New York Times* (15 February 2011), online: <http://www.nytimes.com/2011/02/16/world/asia/16kabulbank.html?_r=0>.

but noted numerous instances of regulatory weakness that it worried might indicate dysfunctionality of the sector as a whole.[227] These restrained fears would later be confirmed by the Kabul Bank crisis in 2010.

The crisis massively discredited the work of USAID and its contractor advising DAB (see below), leaving a legitimacy and capacity void into which the IMF stepped to compensate.[228] It provided direct assistance to DAB with the Kabul Bank bankruptcy proceedings and with its lender-of-last resort loan, and urged the Afghan Government to take strong action to restore international and domestic confidence in the economy. The IMF assumed its new role with vigour, determined to rescue the country and its economy from the fallout from the crisis.[229] When the Karzai administration demonstrated its reluctance to take strong action to dispose of Kabul Bank and investigate and prosecute its managers and shareholders, the IMF used the threat of a non-renewal of its $120 million Extended Credit Facility as leverage to pressure it to accept placing Kabul Bank into receivership and commissioning a full forensic audit of its records.[230] Four months after the first run on the bank, the Government eventually relented.[231]

The IMF's primary objective after 2010 was to rebuild public confidence in the banking sector and to recover at least some of the $1 billion in assets that had been

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227 Elhage et al, *supra* note 206 at 21.

228 The World Bank also stepped in with an $8 million Afghanistan Financial Sector Strengthening Project at DAB in 2011 that was to create a training institute for bank workers and launch DAB's Collateral Registry. The project ended early, however, due to unsatisfactory results that it blamed in part on security concerns and for being insufficiently robust to fill the holes left behind when the U.S. advisors were expelled from DAB and their programs terminated by USAID. Special Inspector General for Afghanistan Reconstruction, *supra* note 216 at 10–11.

229 Rubin, *supra* note 226.

230 Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 49; International Monetary Fund, *Islamic Republic of Afghanistan: First Review Under the Extended Credit Facility Arrangement, Request for Waiver of Nonobservance of a Performance Criterion, Modification of Performance Criteria, and Rephasing of Disbursements*, IMF Country Report 12/245 (Washington D.C.: International Monetary Fund, 2012) at 6. The goals of the 2011-approved ECF were to: "to make progress toward a stable and sustainable macroeconomic position, move toward fiscal sustainability, strengthen the financial sector, and improve the transparency and effectiveness of public spending while protecting the poor, and strengthening the governance framework in the financial and economic sphere. The resolution of failed Kabul Bank, including asset recovery, features prominently throughout the program to ensure that accountability and the rule of law are enforced, and that fiscal costs are contained."

231 Alissa J Rubin & Rod Nordland, "Officials in Afghanistan Begin Investigation into Possible Fraud at Troubled Bank", *New York Times* (14 January 2011).

lost.[232] Bankruptcy proceedings against Kabul Bank would provide the government with the strongest means and legal authority to do this, so it advised DAB on how to exercise its aggressive seizure powers and engage the bankruptcy procedures outlined in the *Law of Banking*. It also provided additional training and support to improve DAB's supervisory capacity, and began to draft new banking legislation based on lessons learned from the crisis.[233] The new banking law is currently being designed to "help prevent, mitigate, and effectively respond to the problems in the financial sector… [to] strengthen corporate governance provisions, regulate capital requirements, large exposures, and related parties, as well as enhance supervision and bank resolution."[234]

Micro - United States Agency for International Development (USAID)

USAID is the primary arm of the U.S. Government charged with international development activities.[235] After the 9/11 attacks and the start of the Bush Administration's 'War on Terror,' it took a year and a half for the U.S. Government to determine what role USAID would have in a post-Taliban Afghanistan. In 2003, it provided it with a massively expanded mandate and funding to deliver wide-ranging, complex development projects strategically aimed at fostering economic growth and strengthening the capacity of the Afghan Government.

The U.S. Government was willing to invest heavily in Afghan banking reform because it had a strategic interest in the stabilization and growth of the Afghan economy.[236] In the post-9/11 "War on Terror," development assistance to "fragile states," including Afghanistan, became a key strategic arm of American foreign policy, explicitly

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[232] Partlow, *supra* note 213.

[233] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 207 at 62; Special Inspector General for Afghanistan Reconstruction, *supra* note 215 at p. 9.

[234] International Monetary Fund, *supra* note 230 at 12.

[235] Created in 1961, USAID has been a technically independent agency within the U.S. Government since 1999. It represents 1% of the U.S. Government's overall budget, and in 2013, reserved $8.2 billion of its $51.6 billion total budget for Overseas Contingency Operations (OCO) in Iraq, Afghanistan and Pakistan. See also the U.S. Government Fact Sheet on this matter available at: http://www.state.gov/r/pa/prs/ps/2012/02/183808.htm. See also Curt Tarnoff & Larry Nowels, *Foreign Aid: An Introductory Overview of U.S. Programs and Policy*, CRS Report for Congress 98-916 (Washington D.C.: Congressional Research Service - The Library of Congress, 2005) at 23.

[236] Such a policy approach held that, "the extent to which countries can successfully make the transition and maintain democratic governments and market economies will significantly affect U.S. security and economic objectives and, ultimately, the U.S. budget." United States Government Accountability Office (GAO), *GAO Strategic Plan 2004-2009* (Washington D.C.: GAO, 2004) at 177.

linked to "using foreign aid to combat terrorism."[237] The creation of a flourishing private sector with a robust banking industry was seen as one of many ways that USAID pursued this strategic objective. In 2003, it launched its $98 million "Sustainable Economic Policy and Institutional Reform Support Program" (SEPIRS) project.[238] A U.S.-based affiliate of a multi-national management consulting firm called BearingPoint Inc. (later bought by Deloitte LLP in 2009)[239] won the tender for the project, which, for the next seven years, among other activities, placed foreign consultants at DAB to promulgate and implement a new banking law.[240]

USAID was tasked to work in an unfamiliar context in those early years after the 9/11 attacks. It was unused to managing multiple, extremely large development projects in fragile, difficult operational theatres like Afghanistan.[241] According to numerous internal audits and reviews of its work, throughout the subsequent decade it struggled to effectively supervise the work of a plethora of contractors working on a large number of diverse multi-million dollar projects around the country. Its supervision of BearingPoint/ Deloitte was no exception and USAID was later criticized for knowing relatively little about their work at DAB and the impact it had.[242]

A 2011 internal report noted that prior to the 2010 crisis, USAID had been generally

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[237] USAID saw fragile states as threats because they offered "the most permissive environments and the least resistance for [terrorism and international criminality]." As such, USAID adopted five core operational goals of: " a) promoting transformational development, b) strengthening fragile states, c) providing humanitarian relief, d) supporting U.S. geostrategic interests, and e) mitigating global and transnational ills." The long-term expectation of this approach was based on the belief that "[s]table, prosperous, democratic nations make better partner for the United States as they address their own interests from a foundation of interdependence. And, such countries offer growing opportunities for mutually beneficial trade and investment." Bureau for Policy and Program Coordination, *U.S. Foreign Aid - Meeting the Challenges of the 21st Century*, White Paper (Washington D.C.: US. Agency for International Development (USAID), 2004) at 5; Tarnoff & Nowels, *supra* note 235 at 2.

[238] Tarnoff & Nowels, *supra* note 235 at 23.

[239] The U.S. branch of BearingPoint Inc. was acquired by Deloitte LLP in 2009 when the former declared bankruptcy that same year. Deloitte then assumed BearingPoint's Afghanistan contracts on August 15, 2009, including that to provide Da Afghanistan Bank technical assistance. Throughout this paper they will be referred to either separately or concurrently, depending on the context.

[240] Afghanistan would not have an elected legislature to review new legislation for another two years.

[241] Tarnoff & Nowels, *supra* note 235 at 23.

[242] USAID Office of Inspector General, *Audit of the Sustainable Economic Policy and Institutional Reform Support (SEPIRS) Program at USAID/Afghanistan*, Audit 5-306-04-005-P (Manila, Philippines, 2004) at 5. A year later, a 2005 Government Accountability Office report found that USAID did not appear to have the capacity to adequately supervise their contracts. See United States Government Accountability Office (GAO), *Despite Some Progress, Deteriorating Security and Other Obstacles Continue to Threaten Achievement of U.S. Goals*, Report to Congressional Committees GAO-05-742 (Washington D.C.: GAO, 2005) at 43.

ignorant of the scope of fraud at some banks and of DAB's ineffectiveness as a regulator because its officers in Kabul had only a superficial understanding of the work the BearingPoint/Deloitte advisors were doing at DAB.[243] Instead, macro-economic reports of rapid growth in the banking sector over the decade lulled it into a sense of optimism that its banking work was achieving the positive results it had set out to do.[244]

By early 2010, however, as more and more reports and allegations of fraud at Kabul Bank come to light, USAID became alarmed at the implications that a possible bank failure held for its huge, 8-year investment. Eager to contain the financial and political fallout, and recognizing it needed help, it formed a "Financial Sector Working Group," with representatives from the U.S. Treasury, the IMF, the World Bank, and Deloitte, who together coordinated an international response to the crisis to ensure that nation-wide economic collapse was avoided.[245] Meanwhile, it came under intense pressure from Washington to account for the millions spent on its economic governance projects the previous decade. It was subjected to two separate formal investigations, both of which found that, contrary to its earlier, misguided and ill-informed optimism, the banking sector it had helped create suffered from deep and systemic vulnerabilities, and that the work of its contractors had failed to make DAB sufficiently capable to properly regulate it.[246] Forced to respond, USAID terminated Deloitte's project at DAB in June 2011. After President Karzai barred any further U.S. government assistance at DAB that same year, USAID withdraw entirely from DAB. It has not resumed activities there since.[247]

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[243] The report noted that: "USAID/Afghanistan's oversight of the task order with Deloitte was weak. Because the mission was short-staffed, it did not have adequate technical expertise to recognize the warning signals at Kabul Bank or to provide adequate direction to Deloitte. As a result, USAID lost opportunities to take appropriate actions and work with Deloitte, Treasury, State, DAB, and the donor community to contain the problems at Kabul Bank… In August 2009… the Office of Economic Growth had only four U.S. direct-hire staff and none with experience in the banking sector. For the most part, only one U.S. direct hire was managing the task order at any given time, with some assistance from Foreign Service National staff." USAID Office of the Inspector General, *Review of USAID/Afghanistan's Bank Supervision Assistance Activities and the Kabul Bank Crisis*, Performance Review F-306-11-003-S (Washington D.C.: U.S. Agency for International Development, 2011) at 3–4, 8.

[244] Booz Allen Hamilton, *supra* note 184 at 55–56.

[245] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 49.

[246] The two investigations were conducted by USAID's internal Office of the Inspector General in 2011 and the independent Special Inspector General for Afghanistan Reconstruction in 2014.

[247] Instead it has shifted its attention towards the commercial banks instead, recently launching a 5-year, $74 million "Financial Access for Investing in the Development of Afghanistan program instead. Activities in this new project include: technical assistance to banks on banking fundamentals; assisting

Micro - BearingPoint Inc. / Deloitte

The SEPIRS project was the first of three large consecutive economic governance projects that BearingPoint/ Deloitte was contracted by USAID to implement from 2003 onwards.[248] Through these projects, BearingPoint/Deloitte advisors provided assistance to DAB to: "[help] the Afghan Central Bank establish national and international operations via standard banking telecommunications networks, implement bank licensing policies and procedures, restructure and equip branch banks, and draft banking laws."[249] From the start, it was understood that the project's objectives were mostly macroeconomic in nature. This was reflected what little data BearingPoint provided to USAID about its work between 2003-2004, when it reported numbers of "independent banks established" (6) and "number of existing banks relicensed" (2), along with a number of capital liquidity indicators, like domestic funds transfers (391), issued loan amounts ($33.5 million), deposit growth ($116.6 million), capital note transactions (600 million Afghanis), dollar value of foreign exchange cash transactions ($525.5 million), dollar value of foreign exchange wire transactions) ($1.273 billion).[250] This preoccupation with macro-economic growth statistics de-emphasized other less tangible change factors to which less attention was paid, like informal trends in banking behaviour, the distribution of the economic benefits of banking sector, or DAB's political capacity to control the banks, factors that would later prove critical in shaping this sector.

The record of BearingPoint/Deloitte's work in Afghanistan is mixed. Shortly after the 2010 crisis, DAB described the Deloitte advisors as being generally useful with theoretical advice and offsite examinations, but considerably less useful with assisting with onsite bank examinations, mostly because they did not accompany investigators

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women entrepreneurs with business development and training; facilitating private sector loans; and supporting the Afghanistan Banks Association, the Afghanistan Institute for Banking and Finance, and the Afghanistan Microfinance Association. Special Inspector General for Afghanistan Reconstruction, *supra* note 216 at 6–7.

248 *Ibid* at 6. The other two were follow-up projects to SEPIRS, namely the three year $46 million Economic Governance and Private Sector Strengthening Program (EGPSS), followed in turn by the $92 million Economic Growth and Governance Initiative (EGGI).

249 United States Government Accountability Office (GAO), *supra* note 242 at 27.

250 *Ibid* at 77.

undertaking examinations due to security concerns.[251] Deloitte readily acknowledged that its consultants were extremely challenged in their work, particularly when it came to detecting the scope of fraudulent practices in the banking sector. It was too difficult to tell fact from fiction in an economic environment saturated with rumour, corruption and intrigue.[252] Although they were aware, to some degree, of possible fraud at a number of banks including Kabul Bank prior to 2010, BearingPoint/Deloitte advisors at DAB did not fully investigate or report this to USAID because doing so was beyond both their contractual mandate and their logistical capability. When details about the actual extent of fraud at Kabul Bank and throughout the banking sector started coming to light in 2010, BearingPoint/Deloitte received severe criticism for not having taken more active steps to prevent it.[253] Although this may have overstated the degree of control they exercised at DAB, that criticism was serious enough to prompt USAID to prematurely terminate their work at DAB in 2011. From then on, Deloitte has played no further role in Afghanistan's banking sector.

Micro - Da Afghanistan Bank (DAB)

In 2002, the IMF recommended a central bank-driven model to the Afghan Government whereby DAB would regulate and supervise a private banking sector and do what it could to encourage investment and growth. This was an ambitious vision of change. By 2001, Afghanistan had not had a private banking industry for decades. DAB

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[251] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 34. Part of the reason for poor support to on-site examinations was the worsening security situation. In November 2008, one BearingPoint advisor received death threats linked to onsite examinations of Kabul Bank and another bank. From this point onwards, with USAID approval, onsite examinations by BearingPoint advisors was discontinued and its technical assistance limited to in-house offerings. A review of USAID's role in the bank crisis found that: "Both USAID and BearingPoint dismissed the death threats as related to operating in a dangerous war zone environment rather than as a red flag signaling a high risk of irregularities or problems at Kabul Bank. A senior USAID official with extensive banking experience later explained that USAID and its advisers should have reinforced offsite assistance for bank examinations, taken other steps to search for possible fraud at Kabul Bank, or discontinued assistance altogether." See Office of the Inspector General, *supra* note 243 at 5.

[252] In this 2011 investigation, the head of the Deloitte team reported that "his professional judgment and risk tolerance were probably clouded by the Afghanistan context of incessant rumors of fraud and corruption and that consequently he did not take the fraud indications seriously. At the time, he thought that the Kabul Bank issues, if any, could be contained. Also, USAID staff members were too inexperienced or too busy to ask appropriate questions about this part of Deloitte's work at DAB." Office of the Inspector General, *supra* note 243 at 7.

[253] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 42.

had been exercising centralized executive authority over six subordinate, state-owned banks for nearly thirty years. Its banks had been nationalized in the 1970s, but by the end of the chaotic *mujahideen* and Taliban periods of the 1990s, it had declined into almost total ruin, and the informal *hawala* networks were the sole means for Afghans to effectively finance their needs or transfer money abroad and around the country. Thus, not only was the banking sector non-functional in 2001, DAB also had no institutional history as an autonomous regulator or supervisor of a private banking sector.[254] It had no automation or computerization, was unable to produce accurate financial reporting, and had not produced a balance sheet for seven years. Little, if any, of the data that it did collect was related to what would be considered prudential benchmarks by international banking practice. IMF concluded that given this, "[b]anking supervision in DAB therefore needed to be built from scratch."[255] For international observers, the key challenge was to repeat the East European experiment of the 1990s of turning formerly-Communist central banks into regulatory supervisors to nurture nascent, competitive, market-based banking systems, except in an extremely dilapidated country, wrecked by warfare.[256] In 2002, the IMF observed that DAB lacked most features of a modern central bank. It had no monetary policy, no banking supervision or market operations departments, and had no independent research capacity. Its Soviet-era accounting systems were not in line with prevailing international standards.

When USAID and BearingPoint assumed the lead in banking reform from the IMF in 2003, this structural reform objective was maintained. With their assistance, the Afghan Government established a policy framework that intended to use the new legal

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254 International Monetary Fund, *supra* note 174 at 120–121.

255 *Ibid* at 119–123.

256 *Ibid* at 120–121; Sylvia Maxfield, *Gatekeepers of Growth: The International Political Economy of Central Banking in Developing Countries* (Princeton, N.J.: Princeton University Press, 1997) at 11. It is worth noting that such an approach is not typical of western industrialized countries. Both Canada and the United States, for instance, partly because of their federal composition, have multiple regulatory authorities overseeing bank operations that are not resident in their central banks. Several European countries, such as the U.K. and Germany, retain monetary policy within the central banks, while siphoning off prudential regulation to independent agencies. In the aftermath of the financial crisis of 2008, the European Union is currently contemplating a supra-national meta-supervisory function for its own central bank authority, a prospect that has proven to be highly contentious. See, Alex Barker, "The German Veto on EU Banking Regulation," The Financial Times Brussels Blog, March 11, 2014, online: The Financial Times Brussels Blog at: <http://blogs.ft.com/brusselsblog/2014/03/the-german-veto-on-eu-banking-regulation/>.

framework for banking to attract investment, get capital circulating in the economy, and have government play an indirect, and less controlling role than it had in the past.[257] The model's priority was growth, and regulation was a technical means of encouraging confidence in the system needed to attract and retain capital in the country.[258] Both the Afghan authorities and the international donors and advisors it interacted with presumed that Afghanistan required a 'modern' banking system. The basic requirements for such a system were prudential regulations to control risky and fraudulent practices, as well as compliant banks and capable supervisory authorities that were able and willing to monitor them, assess their risk profiles, and enforce regulations when required.[259] DAB, in its new and unfamiliar regulatory role as an arm's length banking supervisor was steered by this state policy to make "concerted efforts in creating an enabling environment for the private sector and in pushing forward with public sector reforms redefining the state as the regulator of the private sector - not its competitor."[260]

Within the first year, the IMF reported that considerable progress had been made.[261] Four years later, it reported that DAB was appropriately using international CAMEL standards[262] to evaluate the banking sector, and was taking some corrective measures in response to regulatory violations, mostly consisting of periodic monitoring and targeted examinations. However, through the 2000s, DAB suffered from a limited internal and political capacity to fulfil its regulatory role. Despite having broad authority under the new banking law, its regulatory power was initially limited to controlling access to banking licenses. Its supervisory function only became operational in 2005 two years after the law was promulgated, however, by which time most banks in the market had

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257 Government of the Islamic Republic of Afghanistan, *Securing Afghanistan's Future: Accomplishments and the Strategic Path Forward*, Government/International Agency Report (2004) at 63.

258 *Ibid* at 73.

259 Pavlovic & Charap, *supra* note 172 at 4.

260 Government of the Islamic Republic of Afghanistan, *supra* note 257 at 70.

261 The IMF reported that, "a new Supervision Department has been created, a number of prudential regulations and manuals have been drafted, and the training of supervisors has been initiated. In the first phase, staff received training in the basic balance sheet analysis and concepts of prudential ratios. More recently, and under the supervision of a foreign expert, the staff has been conducting 'real life' off-site supervisions of the operating banks and on-site supervision of Bank-e-Millie Afghan." International Monetary Fund, *supra* note 174 at 133.

262 "CAMEL" is a standard international banking assessment tool, and stands for: Capital adequacy (C), Asset quality (A), Management quality (M), Earnings (E), and Liquidity (L). Elhage et al, *supra* note 206 at 16.

already established themselves and their business practices. DAB's first investigation of Kabul Bank, for instance, did not occur until 2007, three years after the latter was founded.[263] Thereafter until 2010, it conducted seven examinations of Kabul Bank and issued demands for correction four times. Prior to the crisis, however, the management of Kabul Bank showed little inclination to make more than token changes to its practices.[264]

To complicate things further, DAB was chronically under-staffed[265] and faced considerable political pressure to act with restraint. Although bank regulators around the world "are generally reluctant to enforce severe corrective measures due to potential disruptions that public revelations of such measures could trigger in financial markets with low levels of confidence,"[266] this was coupled with explicit political interference in its work either by powerful senior bank officials, or by those who stood to make a lot of money from how the banks were pursuing profits. The disincentive for action that this created for DAB investigators is evident in an anecdote from a 2011 USAID investigation into the 2010 crisis, where,

> [d]uring a training course on enforcement actions, the [Deloitte] advisers came to sense that there was something different about Kabul Bank. For example, the DAB examiners looked incredulous when the adviser suggested that DAB had the power to remove bank management. The adviser probed the views of the examiners by asking: You do not think DAB can remove the chief executive officer of Kabul Bank? The response from the examiners was: He can remove us.[267]

In the early years of its new life, therefore, the context of DAB's work gave it a strong incentive to regulate with a light touch. Its capacity to monitor and investigate bank activities was slow to start and never became sufficient to be fully effective. Despite its overall optimism, the IMF observed in 2008 that DAB appeared hesitant and unwilling to fully engage its powers of enforcement beyond notifying banks of their regulatory

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263 Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 33.
264 *Ibid* at 33–34.
265 *Ibid* at 33. Even as late as 2008, DAB's supervision office consisted of "just over 20 staff members without extensive training in banking supervision."
266 *Ibid* at 65.
267 Office of the Inspector General, *supra* note 243 at 5.

transgressions and demanding correction.[268] This was because by the time it had achieved some operational capacity in 2005, it was already politically dangerous for DAB to exercise its full authority. These created strong, determinative behavioural restraints on its work, and dislodging DAB from them would require an extreme change of circumstance to break their hold.

The 2010 Kabul Bank crisis was, to a limited degree, such a circumstance. With depositors in a panic and the international community's confidence shattered, the crisis created a demand and political opportunity for DAB to assume a more assertive regulatory role. With IMF support, it more fully engaged its powers under the *Law of Banking* to seize Kabul Bank and remove its senior management in late August 2010. Shortly thereafter, on September 5, 2010, it placed the bank under conservatorship, replaced its senior management with DAB staff, and launched bankruptcy proceedings at the FDRC.[269] It took active steps to call back outstanding loans and seize holdings owned either by Kabul Bank itself or it two prime shareholders.[270] Whatever assets remained with Kabul Bank (mostly deposits) were severed from its liabilities and used to create a new bank, the "New Kabul Bank," of which Ministry of Finance agreed to assume ownership, with plans to sell it off to recoup some of the $1 billion that had been lost.[271]

DAB, with help from its international advisors, before they were expelled in 2011, took this opportunity to re-evaluate its own role in the crisis. It conducted an internal "lessons learned" review in 2010, which recommended enhanced examination techniques, stricter application of fitness tests for bank owners and managers, and deeper examinations of bank activities. It increased the number of its enforcement actions and conducted additional audits of ten other banks, which "largely confirmed … that the sector is vulnerable to inadequate capital, deficiencies in governance, and excessive exposures."[272] Yet, in spite of its stronger mandate, DAB continues to struggle with insufficient human and technical capacity to meet the demands of its role and must still

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[268] Elhage et al, *supra* note 206 at 19.

[269] Article 53 of the Law on Banking requires DAB to place any bank under conservatorship whenever its assets are less than its liabilities, it cannot pay its debts, it fails to fulfill a DAB order, or there is evidence or reasonable cause to assume that it has been engaged in criminal activities. *Law of Banking* Art. 53.

[270] Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 48.

[271] *Ibid* at 62.

[272] *Ibid* at 62–63.

contend with powerful political and business interests that its work could run against. It still has great difficulty recruiting and retaining talented and experienced personnel. When some former DAB officials were publicly singled out and prosecuted in the civil and criminal investigations that followed the crisis, recruiting new staff bank examiners became even more difficult.[273] The loss of USAID technical support to DAB has made this situation even more precarious, support that has not been fully replaced by the IMF's continuing and ongoing assistance.

Micro - Banks

Afghanistan's banking sector grew from six non-functional state-owned banks in 2001 to 16 licensed and fully operational private commercial banks with 171 branches in 20 provinces throughout the country in half a decade.[274] The Afghan and international banks entered a new economy and marketplace that was full of potential. Assets in the banking system ballooned to $388 million in 2005 and $1.3 billion in 2007.[275] It was also equally risky, however, with little to no protection for investments available from state authorities. The manner in which bank business practices evolved over the decade that followed largely reflect this contextual reality and these practices directly contributed to the weaknesses of the regulatory environment that emerged.

Afghanistan's new banks employed widely different approaches to lending.[276] The international banks tended to not lend at all because the underdeveloped legal and regulatory environment had no functioning collateral and credit registry system, and no reliable judiciary to impartially protect their investments. Domestic banks, however, were quite willing to lend in spite of these risks.[277] For outside observers, this was strange, since the risks were so high that it seemed hardly worth it to lend at all. The IMF found it "difficult to understand why banks engage in this unprofitable, labour intensive and

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[273] Special Inspector General for Afghanistan Reconstruction, *supra* note 216 at 9.
[274] Pavlovic & Charap, *supra* note 172 at 8–9.
[275] Elhage et al, *supra* note 206 at 14.
[276] Pavlovic & Charap, *supra* note 172 at 3.
[277] Jake Cusack & Erik Malmstrom, *Bactrian Gold: Challenges and Hope for Private-Sector Development in Afghanistan*, Kauffman Foundation Research Series: Expeditionary Economics (Kansas City, MO: Ewing Marion Kauffman Foundation, 2011) at 11.

highly risky activity."[278] This confusion can be partly explained by appreciating that the new regulatory model selected for Afghanistan in 2003 was one designed to regulate banking behaviour in an environment with functional institutions that could enforce contracts, process mortgages and bankruptcies, and guarantee secure transactions. Whatever hopes had existed in 2003 that such institutions might emerge in subsequent years had failed to materialize. For banks to pursue profits by lending money without such institutional guarantees in place, they had to compensate in ways not anticipated by the model. Thus, in 2009 the IMF reported that,

> Most banks did not attach particular importance to analysis of borrowers' balance sheets, cash flow, or business plans as an indicator of creditworthiness. Few banks requested such documents from clients since credibly audited balance sheets were not available… While collateral was required by most banks, the extent to which it was used to assess the creditworthiness of borrowers varied across banks… Faced with the absence of a credit registry, banks appeared to give priority to the reputation of the borrower, relations to other businesses, or personal contacts: Most banks were proactive in gathering information on their customers, including their business operations, the borrower's physical presence in the country, the level of inventories, dealings between different customers, and the borrower's health. [279]

The IMF also reported that banks were using unconventional means of recovering loans, such as personal mediation and threats of being 'blacklisted,'[280] while others reported cases of banks using local chambers of commerce as intermediaries to negotiate repayment plans, or enlisting the support of public prosecutors to threaten borrowers to repay.[281]

The insecurity of the lending environment also limited options of where and to whom banks could lend with some hope of recovery.[282] The *Law of Banking* regulations required banks to spread their risk and avoid sector concentration in their loan

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278 Pavlovic & Charap, *supra* note 172 at 20.
279 *Ibid* at 17–18.
280 *Ibid*.
281 Leach, *supra* note 187 at 31.
282 Cusack and Malmstrom have labeled this effect as the "missing middle" in Afghanistan, where credit is available at the microcredit level, either from microcredit banks or interpersonal loans, or for large scale infrastructural projects for borrowers with sufficient personal influence, but little in between. Cusack & Malmstrom, *supra* note 277 at 10.

portfolios.[283] However, when lending occurred predominantly through personal networks of trust and reputation, bank loan portfolios across the board become "highly concentrated in a few borrowers and sectors," particularly the petroleum sector that accounted for over 30% of total loans.[284] When the crisis emerged in 2010, the prospect of failure of the banking sector posed serious concerns for the continued financing of these sectors.

Even after the crisis, these contextual constraints on the business decision-making of Afghan banks did not changed much. The legal and institutional infrastructure to secure investments remains weak, and the capacity and willingness of most businesses in Afghanistan to provide transparent accounting and business planning documentation is no greater today than it was then. The main impact of the crisis instead was to embolden DAB's role as regulator, but other than that the essential market conditions for banks have remained as volatile as ever,[285] although the domestic banks, facing increased scrutiny from DAB, have scaled back their informal lending. The behaviour of foreign banks, of course, has not change at all, and they have retained their typically restrained lending practices. In 2012, the IMF reported "virtually no new net bank lending during the past year, mostly for lack of sound lending opportunities and the general economic and political uncertainty."[286] Thus, while market volatility continues to create incentives for risky, informal lending, such practices are prevented only by actual or threatened DAB intervention. However, the continuing weakness of DAB's capacity, and its sensitivity to political pressures, leaves it an open question whether it will become and remain strong enough to single-handedly dictate bank behaviour into the future.

Micro - Bank Clientele (Depositors)

While the Afghan economy produced impressive growth statistics from 2002 on in terms of growing numbers of banks in the market and levels of gross capital in circulation, considerably less impressive was the number of Afghan citizens who actually

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[283] See *Asset Risk Diversification and Limitations on Large Exposures of Banking Organizations Regulation*, *supra* note 192.

[284] Elhage et al, *supra* note 206 at 14, 18.

[285] Jan Chipchase et al, *In the Hands of God - A Study of Risk & Savings in Afghanistan* (Irvine CA: Frog and The Institute for Money, Technology and Financial Inclusion, 2012) at 20–22.

[286] International Monetary Fund, *supra* note 230 at 6.

used Afghanistan's banks in that same period. The World Bank estimates that only 3% of all Afghans save at formal financial services, and only 9% have accounts at all.[287] If the banking sector had been expected to become an engine to drive the new economy, by and large the vast majority of Afghans were not using them. Uncertain and unstable economic environments create incentives to keep money easily accessible, rather than to deposit it in financial institutions.[288] In addition, extended households in unstable economies tend to pool their funds collectively, rather than deposit them in individual bank accounts. In the context of ubiquitous insecurity in Afghanistan it makes more sense to rely upon such pooled assets of readily available cash in the event of emergency, rather than to place them in long-term investments or even deposit savings.[289] The informal *hawala* sector offered a viable and highly competitive alternative for many that outweighed whatever benefits the banks offered. Unlike the banks, the *hawala* dealers had proven their viability and reliability through decades of conflict and from 2001 to the present and offered largely the same services at lower prices, with better access and efficiency, and more community trust, as well as trusted for being compliant with Islamic and customary traditions.[290] In general, most Afghans simply do not have surplus cash to save, and those that do also harbour concerns about the future of their country, lack faith in its public institutions, and may also have moral religious doubts about whether modern banking standards accommodate Islamic prohibitions on certain kinds of financial transactions.[291] It is difficult to be certain whether political and economic factors or cultural and religious prohibitions are the more prevalent factors that dissuade the majority of Afghans from participating in banking. It is likely a combination of them all. One study of Islamic micro-finance institutions in Afghanistan, a relatively small sector not covered by this paper, for instance, noted a correlation between security and religious considerations when the few Islamic micro-finance programs available to Afghans contracted sharply

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[287] Most Afghans with bank accounts are mandated to have them for employers who make salary payments through them. *Ibid* at 7. See also World Bank, "Financial Inclusion: Afghanistan" online: The World Bank<http://datatopics.worldbank.org/financialinclusion/country/afghanistan>.

[288] Cusack & Malmstrom, *supra* note 278 at 7.

[289] Chipchase et al, *supra* note 286 at 34.

[290] Maimbo, *supra* note 173 at 4.

[291] In one study, informants generally assumed that formal institutions like "the government, the police, the army, and the banks, are propped up, ready to collapse the moment the outsiders leave and the Taliban return." *Ibid* at 27–29.

starting in 2008 "due to deterioration of security conditions, business losses, and inflation".[292]

To conclude, when Afghanistan's new banks entered the market in 2003, they had much to overcome to gain traction with the Afghan public. The low numbers of depositors who opened bank accounts between 2003 to the present are testament to their failure to win their confidence, and the 2010 Kabul Bank crisis did nothing to improve this.[293] Depositor behaviour has remained relatively static, largely because the uncertain and insecure political and economic environment, to whose fortunes the fate of banks are linked in the public imagination, is unchanged. Although the Afghan banking sector was intended to attract investment with its modern, legal regulatory framework, the socio-economic conditions that determine how most Afghans participate in it have relatively little to do with law. Rather, it is the public's perceptions of the banks, the Government and the economy at large, combined with concerns about physical security, economic uncertainty, morality and religion, practicality, and the ready availability of effective and trusted informal alternatives that framed the context of their choices.

Micro - Bank Clientele (Borrowers)

While the banks struggled to overcome the public's wariness about depositing funds with them, local businesses struggled to get access to what capital the banks controlled. A 2010 survey of business attitudes about the economy and governance in Afghanistan found that most had no access to bank credit at all. Only 6% of businesses interviewed reporting that they had obtained loans from banks, while the remainder had to finance their operations with business profits and savings alone.[294] There was no lack of demand for credit, however. Another study from 2012 found that most households and businesses in Afghanistan financed themselves with informal, personal debts, many struggling with

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[292] Blake Gould, "Islamic Microfinance" in Karen Hunt-Ahmed, ed, *Contemporary Islamic Finance: Innovations, Applications and Best Practices* (Hoboken, New Jersey: John Wiley & Sons Inc., 2013) 353 at 360.

[293] In 2012 the IMF reported that "deposits in the banking sector have stagnated at about 20 percent of GDP since mid-2011, reflecting a continued lack of confidence." International Monetary Fund, *supra* note 230 at 6.

[294] Center for International Private Enterprise, *Afghan Business Attitudes on the Economy, Government, and Business Organizations - 2009-2010 Afghanistan Business Survey - Final Report* (Washington D.C.: Center for International Private Enterprise, 2010) at 6.

debt loads much greater than their annual income. Recovery of such loans were secured not by law or public institutions, but through social convention and fear of sanctions from a loss of honour and respectability.[295]

While banks had little incentive to lend outside of the personal networks of their owners and senior management, borrowers had little incentive to demand formality and transparent procedures from the banks because most were unable to provide audited financial statements or business plans to accompany loan requests. Those that were able to produce such information were reluctant to disclose it anyway for fear of a variety of threats including: competition, tax liability, and even kidnapping and extortion.[296] Thus, the same pressures from an insecure and volatile market that prevented banks from lending widely and transparently were the same that encouraged bank owners to "use funds as lines of credit for personal businesses" and issue large loans to influential members of their personal networks, none of whom had cause to object otherwise.[297] In other words, market volatility cause low demand from borrowers for transparent, documented procedures to guide bank lending. The 2010 Kabul Bank crisis did not change this symbiotic relationship. Although the increased vigour of DAB's inspections since the crisis has brought more scrutiny to bear on lending practices, thereby decreasing amounts of loans issued, this has not altered borrower preferences for informal lending arrangements.

Mezzo-Level Analysis

As stated in the previous chapter, mezzo-level phenomena are impressions produced by the aggregate behaviours of communities of micro-level entities. The behaviour of micro-level constituents is determined by their decision-making rationales, which are themselves informed by mezzo-level impressions. Information produced by mezzo-level impressions feed back to the micro-level and may cause such rationales to change, thereby encouraging behavioural changes. It is thus at the mezzo level where equilibrium patterns can first be discerned, where the mezzo information feedback and micro

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[295] Chipchase et al, *supra* note 286 at 33.
[296] Cusack & Malmstrom, *supra* note 277 at 10–11.
[297] *Ibid* at 10.

decision-making relate to one another in either static or dynamic ways. It is on the basis of those patterns that determinations about system change potential can be made.

Mezzo - International Donors

Although the international community in Afghanistan is very heterogeneous,[298] with regard to the banking sector, the number of players directly involved is relatively small and the Afghan government's dependence on international donor funding is quite straightforward.[299] Although their strategic objectives may have differed, the general collective impression that donors gave to the Afghan Government was similar, namely that swift and early monetary and banking sector reform was needed to encourage private investment, stimulate the economy and grow the national revenue base. In 2002, the new transitional government adopted the swift structural reforms proposed by the international community that was bankrolling it, and within a year it announced the remarkable macroeconomic growth they appeared to be generating in the banking sector.[300] The international community was pleased with these quick and positive results, along with others in other sectors, and for a few years Afghanistan was celebrated as "one of the more successful war-torn reconstruction efforts."[301]

From 2004 on, with a growing economy, a new law and multiple operational banks in place, the international community had little reason to take a more intrusive role than it already had in the banking sector.[302] The positive indicators of macroeconomic growth

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298 Lewarne & Snelbecker, *supra* note 220 at 19.

299 In 2010/11, for instance, the total foreign aid to Afghanistan was US$15.7 billion, which was roughly equivalent to the country's entire GDP. Most of that was spent on security, with US$6 billion spent for civilian aid, approximately 40% of GDP. According to the World Bank, "Such aid dependency is almost unique (only a few smaller economies, such as Liberia and West Bank and Gaza, have on occasion received more aid per capita)." Richard Hogg et al, *Afghanistan in Transition: Looking Beyond 2014*, Directions in Development 75848 (Washington D.C.: The World Bank, 2013) at 6. Ministry of Finance & Islamic Republic of Afghanistan, *Development Cooperation Report* (Kabul, Afghanistan, 2012) at 9. In 2012 the Ministry of Finance reported that by July 2012, total foreign aid commitments to Afghanistan from 2001 was US$119 billion.

300 Government of the Islamic Republic of Afghanistan, *supra* note 257 at 63.

301 Lewarne & Snelbecker, *supra* note 220 at 14.

302 Such an approach is also in line with general principles of state reconstruction that encourage local ownership for development be nurtured as soon as possible. See for example the 2005 OECD "Principles for Good International Engagement in Fragile States & Situations," that propose that development leading to eventual "exit from poverty and insecurity" will "need to be driven by their own leadership and people." Organization for Economic Cooperation and Development (OECD), *Principles for Good International Engagement in Fragile States & Situations* (OECD, 2007) at 1.

through that first decade of development satisfied the international community that their early intervention in reforming the banking sector in 2003 had been successful, but also lulled it into wishful thinking that allowed it to redirect its attention and resources elsewhere. By 2006, the collective gaze of the international community had begun to shift increasingly towards Afghanistan's worsening security situation and increasing insurgent violence, booming opium cultivation, and the persistent fragility of state institutions mandated to control them.[303] Until the Kabul Bank crisis, it had little incentive to push the Afghan Government for more aggressive regulatory enforcement and it settled into a complacent equilibrium pattern driven by a faith that the growing economy was a good sign. Revising the prevailing strategy or engaging further funding and project support seemed relatively less necessary than containing the growing insecurity throughout the country.

The Kabul Bank crisis destroyed this complacent pattern and quickly refocused attention towards the banking sector once again. In September 2010, the fate of the billions of dollars invested by international donors in Afghanistan since 2001 seemed to hang in the balance in the face of a potential financial collapse. The crisis galvanized donors to lean heavily on the Afghan Government to do what it could to protect its decade-long investment in the country. Several international donors used their funding as leverage after the crisis, following the IMF's lead by withholding aid support until the Government overcame its initial unwillingness to properly investigate and prosecute its main culprits.[304] The weakness of the banking regulatory environment became the target of at least six major studies that were commissioned to gauge DAB's capacity to effectively oversee and regulate the banking sector, all of which found that its enforcement capacity was lacking and in need of support. Although collapse was averted, the new post-2010 equilibrium is unstable and characterized by international distrust of the Government's economic intentions and its corruption, as well as its pervading doubt

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[303] UN News Centre, "Afghanistan Could Return to Being a 'Failed State,' Warns Security Council Mission Chief", (22 November 2006). Online: UN News Centre <http://www.un.org/apps/news/story.asp?NewsID=20702&Cr=afghan&Cr1=#.U1VPbOZdVLI>.

[304] The lack of IMF confidence in a government can have serious consequences with other donors. Between 2011 and 2012, while the ECF agreement was being finalized, approximately 85% of funds, amounting to $793 million, was withheld by the international community, who awaited final resolution and acquiescence by the Afghan Government to their demands. Special Inspector General for Afghanistan Reconstruction, *supra* note 216 at 5.

about whether its massive support for Afghanistan over the past decade has been worthwhile. Future funding for the country is currently decreasing across the board, and continued support in the future is not guaranteed at all.[305]

Mezzo - The Government of the Islamic Republic of Afghanistan

Since 2001, the Afghan Government as a whole has been faced with the extremely challenging task of simultaneously reconstructing and developing its internal infrastructure, fighting a growing insurgency, building the economy, and somehow cultivating its legitimacy among the Afghan public. Its needs have been great and it has been, and continues to be, highly dependent on the international community's financial and technical contributions to do this.[306] This international support has never been certain or guaranteed to be perpetual, so both the new Afghan government and its donors were supportive of efforts designed to foster rapid economic growth from the start to generate a domestic revenue base. In its National Development Framework of 2002, it made private sector-led growth a fundamental pillar of its strategic vision, with "the administrative apparatus of Government as an enabler and facilitator of private sector development".[307] It ambitiously predicted that it would need at least a 9% per annum growth in the licit economy to ensure "visible economic and social progress".[308]

This context of need placed the government as a whole in a two-pronged equilibrium trap where in the long run it needed sustained economic growth to develop a domestic revenue base, while in the short term it needed to do what it could to show success in growing the economy to maintain the international community's aid commitments to the country. The government's policy orientation towards the private sector produced two types of mezzo level information feedback mechanisms. First, the macro-economic growth it spawned succeeded in maintaining continued international approval and support

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[305] Hogg et al, *supra* note 299 at 9–10.

[306] The scale of need is indeed great. In its first detailed, comprehensive plan, put forward at the international Berlin Conference on Afghanistan in 2004, the Government requested a total commitment of $27.5 billion for a seven-year public investment program from the international donor community. Ashraf Ghani, Michael Carnahan & Clare Lockhart, *Stability, State-Building and Development Assistance: An Outside Perspective*, The Princeton Project on National Security Working Paper (Princeton, N.J.: Princeton University, 2005) at 4–5.

[307] Government of the Islamic Republic of Afghanistan, *supra* note 257 at 72–73.

[308] *Ibid* at 10.

through the years and turned the international community's attentions away from the banking sector. Second, it provided DAB with a clear policy mandate as well as corresponding disincentives to intervene strongly in the economy, since intervention would risk upsetting bank business and might lower confidence in the fragile economy, not to mention upset powerful political and economic interests. Furthermore, DAB's weakness and inaction provided further feedback information to the private sector that there was little political will or technical means available to the Government to control the banking industry or curtail its operations. The banks thus knew that they were relatively free to calculate their own risk and conduct business how they chose.

The Kabul Bank crisis disrupted these equilibrium patterns to a certain degree by altering some of the systemic relationships that had been previously fixed. The main implication of the crisis for the Afghan Government was that it could no longer placate the international community with good economic news. Facing the threat of a loss of millions of dollars in aid contributions if it did not resolve the crisis in a convincing manner, the Government had little choice but to respond with a more active intervention in the economy to re-establish its flagging support. Yet, the crisis severely damaged its international credibility, especially when revelations emerged of the connection between Kabul Bank's fraudulent lending schemes and the President's 2009 re-election campaign, and with the business activities of members of his family.[309] The government was greatly discredited and faced a very real threat of a tremendous loss of international financial support. This created a sudden and very strong incentive for it to demonstrate its control of the economy, rather than just enabling its growth. Yet, at the same time, domestic political realities required it to do so without disrupting established power relations within Afghanistan's ruling and economic elites. The Government first attempted to

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[309] Ellick & Filkins, *supra* note 211. President Karzai's brother Mahmood Karzai, and Vice President Marshall Fahim's brother Haseen Fahim was known to be shareholders in Kabul Bank, shares that had been bought with money loaned to them by the bank's two largest shareholders, Farnood and Frozi. This became particularly embarrassing in November 2012 when the former CEO and the founder of Kabul Bank announced in court that $20 million in funding from Kabul Bank had been given to President Karzai's re-election campaign in 2009, that Haseen Fahim had taken $178 million, that bribes had been paid to government ministers and the Afghan ambassador in Pakistan, among accusations. See Shakeela Ahbrimkhil, "Kabul Bank Chiefs Name Afghan Leaders in Court", *Tolo News* (14 November 2012), online: <http://www.tolonews.com/pa/afghanistan/8350-kabul-bank-chiefs-name-afghan-leaders-in-collapse>.

placate the powerful individuals caught up in the crisis by delaying or obfuscating any official investigations into it, but these efforts were resoundingly condemned by international donors, who responded with threats to withhold committed funds, threats that were strong enough to convince the Government to dispose of Kabul Bank and strengthen DAB's regulatory authority, as well as to initiate civil and criminal prosecutions of the main perpetrators of the crisis.[310] However, further political interference in the civil and criminal proceedings before the country's judiciary that followed were so glaring[311] that despite eventually stabilizing the banking sector and averting economic collapse, international support for the Government has not recovered its faith or committed support, while little change has come to prevailing business practices in the private sector.

Mezzo - Banks

Over the years, Afghanistan's new banks settled into a pattern of business that seemed to work. The volume of business they conducted generated macroeconomic growth indicators that comforted international donors, who maintained their commitment to the Afghan government and left the banking sector to evolve freely. The government, in turn, maintained its economic policy of unfettered private sector-led growth that fed back to the private sector as implied permission to maintain and entrench their business practices. Shortly after the Kabul Bank crisis, the World Bank commissioned an audit of five of Afghanistan's commercial banks, and found widespread, systemic weaknesses in their financial and operational conditions, poor to non-existent internal policies and procedures, and little or no capacity to abide by international accounting standards, poor governance and organizational structures, and numerous regulatory violations.[312] In 2012, the IMF reported that 3/4 of Afghanistan's banks had low to poor CAMEL ratings and were struggling to meet their minimum capital requirements.[313] Thus, in the years that followed the crisis, the general mezzo impression of the banking sector was that it was far more fragile than previously believed. This new realization mainly affected the behaviour

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310 Ellick & Filkins, *supra* note 211.
311 Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208 at 56–62.
312 Special Inspector General for Afghanistan Reconstruction, *supra* note 216 at 6.
313 International Monetary Fund, *supra* note 230 at 12.

of the international community and its relationship with the Afghan government. It did not change business practices or bank relationships with their depositing and borrowing clientele other than restricting access to already scarce loan capital. The only significant change for the banks has been that they now must interact with a more aggressive state regulator that has fewer resources than before to fulfil its mandate.

Mezzo - Bank Clientele (Depositors)

While the vast majority of the population remained unconvinced that the banks represented a credible or accessible means of managing their finances, the fewer than 10% of the population who did were only those who had some faith or vested interest in the economy and the state. Both before and after the crisis, as far as the banks, the Government and the international community have been concerned, the number, composition and distribution of the depositor community has generally been a far less important mezzo-level characteristic than the large and increasing amount of funds they were depositing. The general lack of participation in the banking sector has remained constant due to limited access to branches and credit, as well as serious concerns and doubts about its security, reputation or efficiency and competition from the informal sector. The resilience of this equilibrium pattern is great because to shift these preferences would require large-scale political stabilization, expansion and improvement of banking services, conviction of the cultural and religious complementarity of the banking sector, and legitimatization of the government - a very tall order. The Kabul Bank crisis did nothing to help this, and one can safely predict that Afghans are unlikely to embrace banking on a wide scale in the near future, bar any exceptional contextual change.

Mezzo - Bank Clientele (Borrowers)

Since 2001, the vast majority of Afghan businesses have had no access to bank credit. Those few that did were quite happy to borrow whatever loans the banks would issue along the informal lines that they preferred to secure their investments. This provided a mezzo impression of low demand from potential borrowers for transparent, formal, documented lending practices. This then informed and reinforced the micro-level

decision-making of Afghan banks, which structured their risk profiling and lending decisions according to the preferences of the volatile marketplace for informal practices. Over time, this settled into an equilibrium pattern of entrenched banking practices. Because this pattern is so conditioned by the insecure economic environment, changing business expectations and practices into something resembling what is expected by the *Law of Banking* will be difficult because it will require a whole-scale change to the economy. The Kabul Bank crisis caused relatively little disturbance to this strong and entrenched behavioural pattern. Despite the political turmoil and the post-crisis restrictions on informal lending, the needs and interests of Afghan businesses are unchanged.

Mezzo - Judiciary

The judiciary was not examined at the micro-level because individual judicial behaviour is beyond the scope of this study. However, the mezzo impression of the ubiquitous corruption and lack of trustworthiness of the Afghan judiciary[314] is extremely relevant because it directly impacts the behaviour and risk calculations of Afghanistan's banks, its businesses, and the public at large.[315] Actors in the banking system from the beginning have acted on the assumption that there is no independent, official or neutral authority available to resolve contractual disputes or protect investments, thereby reinforcing the need for informal risk mitigation strategies. It also encouraged the international community to develop innovative fixes to avoid judicial encounters wherever possible.[316] The intricate drama of the civil and criminal prosecutions that

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[314] Transparency International's 2013 Corruption Perceptions Index ranked Afghanistan 175 of 177 countries in the world, above Somalia and North Korea only. USAID, *Assessment of Corruption in Afghanistan* (Washington D.C.: U.S. Agency for International Development, 2009) at 8 A 2009 USAID report noted that: "The justice sector is widely perceived as the most corrupt one in the country. Many Afghans note that justice is a market commodity to be bought and sold, which is particularly troublesome in a society that values justice and honor. The formal justice system of the police, criminal investigators, prosecutors, and judges has numerous points of vulnerability to corruption that are taken advantage of by officials and citizens." Transparency International, *Corruption Perceptions Index 2013* (Berlin, Germany: Transparency International, 2014).

[315] Cusack & Malmstrom, *supra* note 276 at 11 In one recent study, the head of a bank related to researchers that it was easy for debtors to delay or avoid repayments on loans when courts are involved because they "will simply pay small bribes to relevant judges in order to stall attempts to collect collateral."

[316] One such fix was the Financial Disputes Resolution Commission, the body that successfully

followed the Kabul Bank crisis only further demonstrated how dysfunctional and compromised the Afghan judicial system is. Unfortunately, room does not permit going into its details here.[317] However, what is important is that high level political interference caused delays and allowed some serious perpetrators to avoid prosecution, while targeting DAB staff instead, all of which was profoundly troubling at the very least for the international community and DAB itself.[318] It lowered the already low international confidence in the state of the Afghan judicial system and has made talent recruitment at DAB more difficult. Most importantly, however, it likely confirmed and further entrenched the impact that the judiciary's dysfunctionality has on the marketplace. This is a further rigid equilibrium dynamic that is keeping business decision-making practices constant and that will only be changed through great effort to repair the judiciary and regain public confidence in it.

Macro-Level Analysis

Having completed the micro and mezzo-level analyses, it is possible now to speak about the Afghan banking system as a whole in terms of aggregate mezzo-impressions and equilibrium dynamics. The system that evolved following the promulgation of the *Law of Banking* in 2003 grew very rapidly and for the first years was virtually unchecked by government action. By the time the state regulator belatedly began to conduct its first regulatory compliance investigations, banking practices had already entrenched themselves along informal lines not foreseen by the *Law of Banking*. In fact, relatively little formal lending happened along the lines envisioned by the law. Many of the institutional securities required by such a system did not exist to encourage banking participants to abide by formal regulations, and those banks that were willing to lend did so only to known and trusted entities.

The sector, therefore, suffered from considerable dysfunctionality as a formal regulatory system. Banks did not employ regulatory restrictions to guide their behaviour, and instead freely managed their own risk. Kabul Bank was only the worst example of

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adjudicated the Kabul Bank bankruptcy proceedings.

317 It has been documented elsewhere, however. See Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *supra* note 208.

318 *Ibid* at 66.

common banking practice throughout the sector. The crisis caused by the bank's collapse laid bare the weaknesses of the regulatory regime, and part of the official response has been to increase the mandate of DAB to enforce banking regulations. It is unlikely, however, that this alone will counteract the systemic dysfunctionality of the regulatory system as a whole because it is difficult for banks in the Afghan marketplace to issue loans and pursue profits according to its rules. With banks, their clients, and business practices firmly entrenched in the marketplace, any increasingly strict regulatory enforcement may only result in decreasing the availability of credit in the marketplace, since lending on formal lines is not a desirable nor practical way for banks to manage their risks. This, of course, undermines the original objectives of the *Law of Banking*, which was to use the banking sector as an engine of growth and economic development. A new balance will therefore need to be struck, one that can both increase lending, but also restrain risky lending practices in an uncertain economic environment like Afghanistan. It is beyond the scope of this paper to propose such a balance, but work is currently underway to do so elsewhere.[319]

Contributions from Legal Transplant Theory

At this point, it is worth examining whether this multi-layered analysis has succeeded in providing more explanation for *why* the legal and regulatory environment for Afghan banking evolved the way it did after the *Law of Banking* was promulgated in 2003 than the transplant theorists surveyed in Chapter 1. If Alan Watson had ever examined the law, he likely would have been most interested in how the law changed Afghanistan's formal legal system, and would have been unsurprised about the law's foreign origins. It would have made perfect sense to him that a highly technical law was drawn from an external source and replicated in Afghanistan during its institutional reconstruction. Indeed, the dominance of external legal advisors in the process could be a perfect example for him of how the splendid isolation of legal communities from society drives legal change. Legrand, of course, would likely argue that the total absence of prevailing social or cultural realities in the new law would doom the transplant to failure. The multi-layered

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[319] Special Inspector General for Afghanistan Reconstruction, *supra* note 216 at 7, 9.

approach allows for both of these viewpoints to hold true simultaneously. The rushed, early legal reform was able to meet its short-term objectives by changing the formal legal framework and growing a private banking sector out of nothing. At the same time, however, the lack of appreciation that the law had for the volatile post-conflict market dynamics and lack of institutional robustness over time created incentives for actors to disregard the law. Yet, although the law did not replicate a perfect, modern banking system, it did, at least, create a banking sector, flawed though it was. Furthermore, its seizure and bankruptcy provisions were relied upon to provide at least an ordered procedural resolution to the Kabul Bank crisis.

Watson and Legrand's depictions of legal transplants are useful partial explanations of how Afghanistan changed or how it failed to replicate the model its reform was based on, but they do not offer very much explanation for *why* the banking sector as a legal-regulatory environment evolved in the way that it did. Teubner provides some additional perspective on this, and might have argued that the mismatch between the *Law of Banking* and the prevailing socio-economic conditions did not necessarily doom it to failure but rather caused an "irritating" process, whose dynamics changed both the socio-economic environment and the manner in which the law was implemented. Roger Cotterrell could provide further assistance describing those dynamics in terms of multiple points of overlap and conflict between social 'communities' vying for control over the regulatory environment, a contest that Lawrence Friedman might argue was really a struggle to determine the course of Afghanistan's modernization. Rather than simply causing social or legal "irritation" or being a site for social conflict and struggle, the multi-layered approach describes how the *Law of Banking* created a space for a modern, private banking sector to emerge. Within that sector, the dynamics of the relations between international actors, the Afghan Government, the banks and the public played themselves out in such a way that after a decade, it encouraged particular behaviours among those actors who participated in it. These behaviours then collectively created systemic vulnerabilities and limited public participation that the law had not foreseen.

The multi-layered analysis also explains in what ways 'demand', 'prestige', or 'efficiency' may have mattered or not in this case study. It shows that Afghan society or its legal system did not fail to 'demand' law because of the system's lack of 'health' or

'legality', as Berkowitz, Pistor and Richards might claim, but rather because key actors in the banking system collectively had little incentive to abide by or implement it. Similarly, in contrast to Mattei or Sacco's arguments, the approach shows that whether a law is chosen or followed because of its inherent 'efficient' or 'prestigious' qualities depends on whether or not those are incentive-creating factors for the actors that are choosing to act upon it. The *Law of Banking* was chosen for transplantation because the dominant actor at the time, the IMF, felt it was a proper fit for a system emerging out of a Communist past. It is not immediately obvious whether this was an 'efficient' or a 'prestigious' choice. Paul Szasz and Jonathan Weiner's insights into how international consensus emerges about what constitutes a 'best practice' could explain the IMF's choice of model for Afghanistan in 2001-2003. Regardless, what is certain is that neither the banks, their clients or the public at large felt the new legal regime was efficient, prestigious or a 'best practice.' Instead, pursuing profit and protecting investments in a greatly insecure economic environment made them prefer informal practices that were more efficient for their needs but that collectively weakened the security of the sector overall, rendering it 'unhealthy' as a legal regime, While Berkowitz, Pistor and Richard's study identified a quantitative correlation between 'health' and 'demand for law', the multi-layered approach instead provides a theoretical basis to explain why that correlation exists at all.

With regard to those authors who focused on the international and geopolitical nature of legal transplant processes, although there is little doubt that U.S. intervention in the banking sector was an extension of its strategic aims, as Dezelay and Garth or David Gerber would argue, the multi-layered approach demonstrates that this can only provide a partial explanation for why legal reform inspired by external models evolves how it does once a new law is promulgated. In this sense, it is more aligned with the work of David Nelken, who cautioned that any imposition of globalized norms would always have to contend with local realities.

Finally, the multi-layered approach provides explanations for why typologies like Jonathan Miller's will always be fraught with diversity and variability according to the dynamics of the players involved. Describing the *Law of Banking* as an 'Externally Dictated Transplant' or possibly a 'Legitimacy-Generating Transplant' only assists in

categorizing a transplant's origins, and offers little predictive value thereafter, other than to say that the *Law of Banking* is destined to fail once the prestige or presence of the dominant foreign actors that forced its promulgation leave.

Conclusion: Was the *Law of Banking* a "Success"?

The central question for this case study: how can one understand what determined whether or not and how the *Law of Banking* would be incorporated into Afghanistan's social and legal environments once it was promulgated in 2003? The multi-layered approach to domestic legal reform inspired by external models used in this case study provided a systems lens through which legal change could be explained in terms of contextualization. It demonstrated how, despite the law not being 'home grown', domestic socio-economic and cultural contextual factors nevertheless determined the participation, or non-participation, of key actors and stakeholders in the banking sector. Furthermore, finding equilibrium patterns within the interplay of those three layers allowed for further explanations of why change happened or did not happen within the banking sector, especially when it was faced with the shock of the Kabul Bank crisis. The case study demonstrated how identifying equilibrium patterns allows for limited prediction of the future, but also illustrates how difficult accurate prediction can be when patterns are not strongly fixed. Thus, on the one hand, one can be certain of volatile market pressures on business and banking, or of a lack of public participation in banking continuing into the future because equilibrium patterns maintaining those behaviours are strong. On the other hand, it is much less certain how DAB's role will evolve, or to what degree international support will continue to be committed to supporting the Afghan banking sector as a whole because their equilibrium patterns are more weakly entrenched.

Any answer to the question of whether the *Law of Banking* 'succeeded' or not will inevitably be variable, nuanced and dependent on whose perspective one adopts. The law was clearly successful in achieving its original short-term objective of stimulating the growth of a private banking sector out of nothing. Furthermore, the manner in which it was relied upon to process the country's first bank bankruptcy and steer the sector away from a general financial crisis was far from a 'failure.' On the other hand, the law never really met the needs of the banks and their clients in the volatile and insecure marketplace

in which they did business, and was therefore largely disregarded as a controlling influence over their behaviour. It failed to engage widespread participation in the banking sector, while those who did participate created systemic vulnerabilities in spite of much of the law's content that was designed to prevent them.

The multi-layered analysis demonstrates that it would be excessive to lay full responsibility for any success or failure of the Afghan banking sector solely on the shoulders of the law itself. Where the law's content came from, be it any single doctrinal system, or an amalgam of international banking 'best practices', is relatively irrelevant insofar as the insecurity of the marketplace produced systemic preferences for informality that would have been difficult for any modern banking framework based on formality and transparency to control. The interaction of all the actors within the Afghan banking regulatory environment created vulnerabilities that undermined the law's original intent, but at the same time the law also provided a means for the system to absorb the impact of an internal bank crisis. Thus, while the *Law of Banking* did not create a pristine, blemish-free banking economy for Afghanistan, thereby clearly failing in a Legrandian sense, it did re-introduce private banking into a country that had had a nationalized, state-owned banking sector for nearly two decades, and virtually none at all for a decade after that. Although it still struggles with trying to operate in a highly insecure environment, and has yet to capture the interest of most Afghans, its banks have still managed to function adequately well for ten years despite that, which is no mean feat at all.

CONCLUSION

The objective of this thesis was to provide a method to assemble the fragments of the current academic discourse around legal transplantation in a coherent way that can simultaneously capture its large theoretical questions while also retaining its relevance and applicability to specific case studies. It has offered a new methodological lens, rather than a revolutionary theoretical perspective, to do this, one that is able to address many of the core concerns that have dogged transplant scholars for decades, but one that also resists making grand claims of its own. It does not resolve debates within the field, but rather provides a methodological space and framework wherein disagreements may persist, but also co-exist, and be better understood in how they relate to one another.

By drawing on 'systems' theories from the scientific realm, this methodological approach provides a means to link micro behaviours to macro phenomena that can accommodate the large-scale theorists like Watson, Kahn-Freund and Legrand without having to trade-off relevance to specific case studies to account for variability. By locating "context" at the micro-level as a variable phenomenological experience that impacts individual decision-making, it avoids having to make any sweeping claims about law and society of its own, while permitting infinite variability across and within legal systems the world over. Furthermore, by adopting equilibrium patterns as the linchpin for understanding system change, this methodological approach provides a means to explain why legal change occurs in some instances and not others. The Afghan banking example demonstrated this by showing how and why change came more easily to those areas in a regulatory environment that were less rigidly tied to equilibrium behavioural patterns than others. It also demonstrated the importance and contribution of stakeholder behaviour to a legal-regulatory system, as well as the limited, albeit important, role that a law's material contents can have on structuring the legal or regulatory environment it

may create. Finally, the description that this methodological approach provides of the interplay between micro behaviours and mezzo impressions in a legal system in terms of information feedback cycles and equilibrium patterns provides a vocabulary that can describe legal change in a way that makes sense to the conflict/contest models of Cotterrell, Dezelay and Garth. Similarly, it satisfies the globalization theories of Koh and Wiener, as well as the "legal formants" approaches of Sacco, Monateri and Mattei, among others.

Despite this unifying effect, by locating the momentum and agency that drives law and legal change primarily in actor behaviour at the micro level, this approach differs considerably from those of many scholars who give 'communities' or even entire legal systems any autonomous capacity to act on their own. By instead making communities and systems subject to the behaviours of their individual constituents, it avoids having to make sweeping generalizations about how communities behave or make decisions, while retaining the flexibility needed to accommodate the variability of behaviour and experience that transplant scholars have struggled so much to describe. Accommodating that variability, however, does not permit any easy or singular way to describe how legal transplants work, or even how and when they 'succeed' or 'fail' as legal reform initiatives. Instead, it takes the position that such processes will always be idiosyncratic, and that judgmental concepts like 'success' are fluid and say as much about the observer as they do about what is observed. By rooting the momentum behind legal change in the behavioural patterns of system actors, it emphasizes that law, as well as the study of law, is fundamentally a human phenomenon that is always contingent on human motives, desires, and commitments to action. Thus, while a legal transplant will never 'irritate' a receiving system, it may irritate the actors within that system, who can be expected to choose to act upon it in ways that make sense in their operational context.

In this sense, this paper is a response to William Ewald's call for a new approach to legal transplantation. Although it cannot claim to be the "future social theory of law" he demanded, it does provide a methodology that incorporates "a cautious awareness of the complexity of the relationship between law and society" that offers some coherence and

cohesiveness to a field that has been so lacking any to date.[320]

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