

Communication : Harmonisation of Contract Law Characterized by Formality and Strong Enforcement Mechanisms Imperative for Economic Development

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1. Introduction

The Organization for the Harmonisation of Commercial law in Africa (known by its French acronym : OHADA) aims at establishing a unified, secure and modern legal environment with a view to boosting economic activity and investment in its member States. The constitutive treaty states as its main objective the harmonisation of business law in its member States. This aim is to be achieved by means of the development of simple, modern rules in keeping with the state of the economies of the member States. These rules should furthermore be implemented by appropriate judicial procedures, and arbitration as the choice of form of dispute resolution should be promoted.

Against this background of OHADA's efforts at presenting a Uniform Act on contract law, it is necessary to present the hypothesis that to achieve economic development the existence of a strong formal contract law and contract enforcement mechanisms are essential.¹ The Nobel laureate Douglass NORTH has held that the inability to develop effective institutions for the enforcement of contracts is the most important cause of historical stagnation and contemporary underdevelopment in the Third World.²

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¹ M.TREBILCOCK / J. LENG, "The role of formal contract law and enforcement in economic development", *Virginia Law Review* 92 (2006), 1517. It is accepted that approximately eighty-five percent of the world's population of 6.5 billion inhabitants live in developing countries while earning only one-fifth of the total world income. Cf. M.P. TODARO / S.C. SMITH, *Economic Development* (2003), 47, 54.

² D.C. NORTH, *Institutions, Institutional Change and Economic Performance* (1990), 54.

2. Contract enforcement mechanisms: formal as opposed to informal institutions of enforcement

Contracts may be characterised by either informal or formal contract enforcement mechanisms. North links the role of institutions in determining economic performance directly to the quality of a countries' institutions.³ Self-enforcement constitutes the primary feature of contracts used in tribes, primitive societies and close-knit small, ethnically homogeneous communities.⁴ Informal enforcement mechanisms appear to encourage and support repeat and/or long term relational exchanges, but fail to be effective in a globalised world where contracting is generally characterised by impersonal simultaneous exchanges.⁵ Accordingly, a credible formal regime of third-party enforcement is essential. North defines "third-party enforcement" as the development of the State as a coercive force able to monitor property rights and enforce contracts effectively.⁶ Third-party enforcement makes provision for certainty and predictability, inspiring parties to enter into non-simultaneous exchanges.⁷ Parties appear to be more willing to enter into contracts with partners from States which act as credible third-party enforcers of contracts concluded within their jurisdiction.⁸ In an attempt at realising such enforcement regimes, the promotion of rule of law reform in developing countries and transition economies has experienced extensive support from international agencies.⁹

However, apart from the contract-formalist approach, an alternative paradigm has emerged which finds support for its non-formalist contract enforcement approach in relational contract theory. This paradigm emphasises the role played by social norms and networks which effect contract enforcement without a third party enforcement mechanism. Relational contract theory explains the nature of long-term contracts as opposed to discrete exchanges.

Discrete exchanges require the minimum of requirements to establish an agreement.¹⁰ An example of a discrete exchange is the purchase of petrol at a

3 *Ibid.*, 3, 107.

4 *Ibid.*, 55.

5 Cf. also TREBILCOCK / LENG, *supra* note 1, 1522, 1527.

6 NORTH, *supra* note 2, 59.

7 TREBILCOCK / LENG, *supra* note 1, 1525f.

8 TREBILCOCK / LENG, *supra* note 1, 1526.

9 DANIELS / TREBILCOCK "The Political Economy of Rule of Law Reform in Developing Countries", 26 *Michigan Journal of International Law* (2004), 99; *Idem*, *Virginia Law Review*, 92 (2006), 1523.

10 Ian R. MACNEIL, *The New Social Contract: An Inquiry into Modern Contractual*

service station along a highway,¹¹ or of a cappuccino in a shop.¹² An essential characteristic of the discrete exchange is presentation. Presentation may be defined as bringing the future into the present. The parties to a discrete exchange are required to set out, at the time of contracting, when, where and how obligations are to be effected in the future.¹³ The aim is to establish, insofar as the law is able to, the entire relation at the time of the expression of mutual assent. Total presentation through 100% predictability is sought as of the time of acceptance of the offer. The underlying rationale of presentation is found in the fact that in classical law, individuals have no obligations to each other except those created by the coercive rules of the State, or the individuals' undertakings to each other in their contract. Consequently, if contract law outcomes are to be rationalised on the basis of *consensus*, the outcomes must appear to flow from the parties' agreement.

On the other hand, long-term contracts (also referred to as relational contracts or intertwined exchanges) differ from discrete exchanges in that they cannot be specific and precise in allocating the respective obligations,¹⁴ and lack a great meeting of the minds in respect of all the terms of the agreement.¹⁵ It is often difficult to discern when they begin and are to end. The content of long-term contracts is formed by means of an incremental process in which parties gather a growing body of information and gradually agree to more and more as they proceed.¹⁶ Relational roles are long-term and involve both primary relations as well as a diversity of ongoing obligations. Thus one finds in relational exchanges intricate linkings of habit, custom, internal principles and rules, social exchange and other social principles, dependence

Relations, Yale University Press, Newhaven (1980), 11.

¹¹ *Idem*, "The many futures of contracts", 47 *Southern California Law Review* (1974), 691, 720ff.

¹² H. COLLINS, "Introduction: The research agenda of implicit dimensions of contracts", in: Campbell / Collins / Wightman (Eds.), *Implicit Dimensions of Contract*, Hart Publishing (2003), 18.

¹³ Ian R. MACNEIL, "Commentary: Restatement (Second) of contracts and presentation", 60 *Virginia Law Review* (1974), 589 (592).

¹⁴ Stewart MACAULAY, "The real and the paper deal", in: *Implicit Dimensions*, *supra* note 12, 81ff.

¹⁵ W.C. WHITFORD, "Ian Macneil's contribution to contracts scholarship", *Wisconsin Law Review* (1985), 545 (547).

¹⁶ Ian R. MACNEIL, "Economic analysis of contractual relations: Its shortfalls and the need for a rich classificatory process", 75 *North Western University Law Review* (1981), 1018 (1041); Stewart MACAULAY, "Non-contractual relations in business: A preliminary study", *American Sociological Review* (1963), 55.

and expectations.¹⁷ In terms of the relational view of contracts, obligations grow out of the commitment which the parties have made to one another together with the conventions that social and economic intercourse – oversimplified under the generic term trade usage – has established for such commitment. They are defined by the fact that the business communities involved in relational contracts do not use formal legal mechanisms to enforce contract terms or to resolve disputes.¹⁸ BERNSTEIN's study of the New York diamond trade provides a good example of a relational exchange which is enforced by the norms of an ethnic business network, in this instance, the Orthodox Jewish network which largely controls the New York diamond industry.¹⁹ TREBILCOCK and LENG²⁰ hold that: "When an entire industry is comprised of one homogenous group that adheres to a single set of operational rules, there is little need to resort to external rules of order." However, as indicated by Bernstein,²¹ when the ethnic composition of the diamond trade began to diversify and new agents entered the industry, the enforcement regime changed accordingly. She explains that formal contract enforcement mechanisms have increased recently, especially through the introduction of legally enforceable contracts and the expansion of legal representation in the diamond trade's internal arbitration process.

3. Conclusion

From the short discourse above one may draw the conclusion that not only is a harmonious system of contract law essential for long-term economic growth, but the presence of a credible formal legal contract regime also appears to be an imperative for developing countries where economic growth is dependent on expanding international trade and on attracting foreign direct investment from contracting parties from different ethnic, cultural or social backgrounds. Thus the underlying principle of any harmonisation project on the law of contract requires a strong formal contract law coupled with third-party enforcement mechanisms.



¹⁷ MACNEIL, *New social contract*, *supra* note 10, 66; COLLINS, "Introduction ... implicit dimensions ...", *supra* note 12, 2.

¹⁸ MACAULAY, "Non-contractual relations ...", *supra* note 16, 55 (61).

¹⁹ Lisa BERNSTEIN, "Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry", 21 *Journal of Legal Studies* (1992), 115, 140f.

²⁰ TREBILCOCK / LENG, *supra* note 1, 1538.

²¹ BERNSTEIN, *supra* note 19, 143, 154-157.