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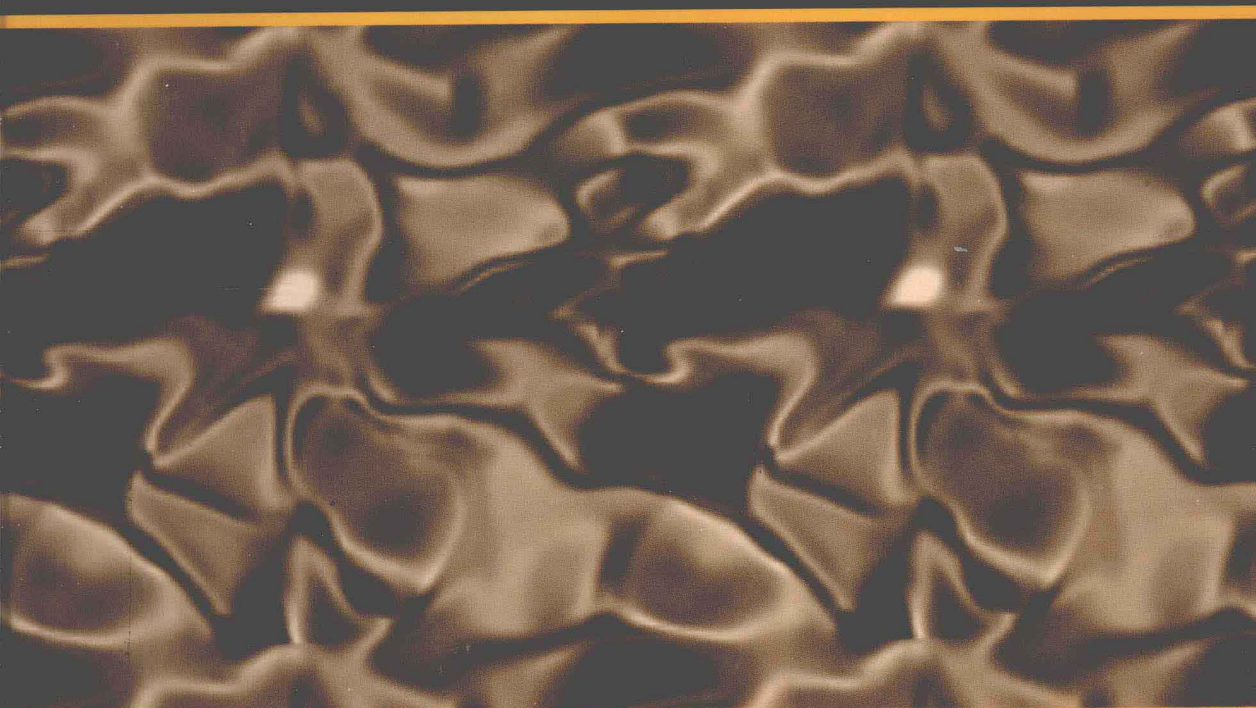
Legal Origin Theory

Edited by **Simon Deakin** and **Katharina Pistor**



ECONOMIC APPROACHES TO LAW 33

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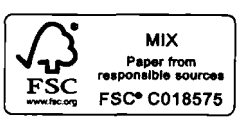

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Introduction

Simon Deakin and Katharina Pistor

The idea that a country's legal origin determines its path of economic development is one of the more influential, but also controversial, ideas to emerge in the social sciences in the past two decades. The literature on legal origin began in the mid-1990s with an intriguing empirical finding. Countries whose legal systems were derived from the common (or English) law did not only regulate markets and business in different ways from those whose legal origins lay in the civil law traditions of France, Germany and the Scandinavian systems; these legal and institutional variations were reflected in economic outcomes. Common law systems were associated with more liquid capital and credit markets (La Porta et al., 1998, Chapter 2 in this volume), and with more flexible labor markets (Botero et al., 2004), features of contemporary economies that were generally thought to be conducive to faster growth. These patterns appeared to reflect deep structural differences across legal systems in the definition of property and contract rights and in the conception of the role of government in regulating the economy. The pro-market approach of the common law stood out in contrast to the statist orientation of the civil law: 'common law stands for the strategy of social control that seeks to support private market outcomes, whereas civil law seeks to replace such outcomes with state-desired allocations' (La Porta et al., 2008: 286, Chapter 3 in this volume). Working backwards from their empirical results, legal origin theorists offered an explanation for them in terms of the path-dependent nature of legal and economic change. Legal institutions had been diffused around the world from just a few parent systems through conquest, colonization and (much more rarely) voluntary adoption, over several centuries (Glaeser and Shleifer, 2002, Chapter 1 in this volume). These institutions, it was claimed, operated as an exogenous force shaping the growth path of national economies, with implications for industrial and market structure, distribution, and politics.

Almost every aspect of the legal origin hypothesis, as we have just described it, is contested. Comparative lawyers have queried the classification of national systems on which legal origin theory is based (Siems, 2005), along with its ascription of particular regulatory styles to different families of legal regimes (Pistor, 2006; Armour et al., 2009, Chapter 10 in this volume). There has been sustained critique from lawyers and economists of the coding methods used to produce data on legal systems (Spamann, 2006, 2010, Chapter 7 in this volume), and of the statistical techniques employed to analyse them (Graff, 2008, Chapter 8 in this volume; Sarkar and Singh, 2010). The coherence of the underlying theory has also been questioned (Ahlering and Deakin, 2007). Despite this, interest in legal origin shows no signs of abating. One of the first legal origin papers, 'Law and Finance', written by Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny (henceforth 'LLSV') and published in 1998 (Chapter 2 in this volume), now has over 1,500 citations on SSRN and over 5,300 on Google Scholar.[1] Econometric papers citing and analysing the datasets created by LLSV appear on a regular basis, and there are extensive legal, historical and comparative

literatures exploring complementary aspects of the legal origin field. Alongside its scholarly and scientific interest, the influence of the legal origin hypothesis on policy has been particularly marked: by the late 2000s, 'literally dozens' of countries had amended their commercial, fiscal or social laws in line with policy recommendations of the World Bank's *Doing Business* reports (La Porta et al., 2008: 326, Chapter 3 in this volume), which are largely based on legal origin methodology and theory (World Bank, various years).

Its huge influence notwithstanding, the merits of the legal origin approach will ultimately have to be judged in the context of the three fields of inquiry for which it has staked important claims: the study of comparative law; the analysis of the relation between law and markets; and the understanding of the role of legal systems in social ordering. We will examine these in turn, highlighting in each case ways in which the original legal origin hypothesis has been modified in the light of subsequent research.

Comparative Law

The classification of legal systems into families according to their historical origins is nothing new. Comparative legal scholars have long organized the world into major groups of legal systems, and have studied differences among them at the level of overall systems, as well as that of specific institutions. When the legal origin literature emerged, comparative legal scholarship had reached broad agreement that, while differences in specific legal institutions had declined, systemic differences across legal systems remained. These were rooted in broadly-defined factors such as national culture and political economy, and in specific institutions such as the modes of organization of the judicial and legal professions (Zweigert and Kötz, 1998; David and Brierly, 1985). However, comparative legal scholarship did not seek to rank legal systems in terms of their supposed effectiveness or efficiency, as the legal origin approach did. It made little if any use of statistical methods, and was not centrally concerned with the economic consequences (or causes) of legal differences. The detailed study and explanation of variations in law and in legal institutions, using interpretive and historical techniques, remained its focus and end.

The legal origin literature made use of some of the classifications developed by comparative lawyers, above all the familiar distinction between common law and civil law systems (while neglecting others, such as the category of Islamic systems, or alternative classification schemes as the one proposed by Mattei, 1997, Chapter 17 in this volume). At the same time it mounted a challenge to the traditional approach by documenting legal differences in a way that made comparative law amenable to statistical analysis, and by relating those differences to economic performance outcomes. The first of these steps, the coding of legal rules into indicators or variables to which mostly binary values (zero or one) were attached, was not in itself especially revolutionary. So-called 'synthetic' indices using similar methods had previously been developed by the OECD, whose Employment Protection Index, measuring legal regulation of the employment relationship, dates back to the early 1990s (Grubb and Wells, 1993). The World Bank was developing, from the mid-1990s, an extensive suite of 'governance' indicators covering such matters as respect for property rights and the constitutional separation of powers (Kaufman et al., 1999) based on survey results, not statutory law. Nor were the econometric methods used by LLSV innovative, in and of themselves. The accumulation of data on,

initially, around 50 countries, later extended to datasets coding for all but a few of the world's nation states, made statistical analysis of cross-national differences possible, and imparted a certain degree of plausibility to the results. However, in the absence of historical data, more novel time-series and panel-data techniques (see Engle and Granger, 1987) could not be used, making it difficult to infer causation as opposed to mere correlation.

The results of the early legal origin studies were, nevertheless, striking: common law countries were more likely to enact or develop legal rules protecting shareholder and creditor rights, and these rules were, in turn, correlated with higher liquidity in stock markets and a more sustained flow of bank-led private credit, respectively (La Porta et al., 1998, Chapter 2 in this volume). In the case of labor laws, a complementary pattern emerged: common law systems regulated the employment relationship less than civil laws ones, engendering more flexible and efficient labor markets, with lower unemployment, higher labor force participation, and a smaller informal economy (Botero et al., 2004). Aware that they could not derive causal relations from these findings without placing them in a wider theoretical and methodological context, LLSV initially suggested the use of legal origin as an 'instrumental variable' capable of isolating the effect of legal rules on the economy (as opposed to vice versa). Except in the case of 'parent systems' (such as England, France or Germany) or the small number of countries which had consciously adopted an existing legal template (as Japan did in the case of Germany's commercial law in the late nineteenth century), legal origin was an institutional feature imposed on a country from outside ('exogenously'), through conquest or colonization. Thus in the vast majority of cases, legal origin could not be said to have been generated internally ('endogenously') by the economic or political conditions of the country concerned. This meant that it was appropriate to use it as an instrument in regression analysis (although neither parent systems nor 'voluntary adopters' were excluded from the analysis, as they might have been). However, in time the theory was refined so that legal origin itself became the focus of analysis. Legal origin was correlated both with the content of legal rules and with their economic outcomes, but as it could not have been the *result* of either, it could be presented as their common, underlying *cause* (La Porta et al., 2008, Chapter 3 in this volume). Thus what began as a methodological move, designed to overcome the limitations of a non-time-variant, cross-sectional analysis, became the basis for a more wide-ranging theoretical claim: legal origin itself, and not just (or even primarily) the content of legal rules, shaped national economic pathways and outcomes.

For a comparative law field dedicated to the study of differences while being receptive to claims of more deep-rooted, functional continuities across legal systems sharing a common, market-orientated economic structure, these findings were a shock. To be sure, it was not the first time that the common law's superiority in economic terms had been proclaimed. In the 1970s several theoretical papers had claimed that the process of competitive litigation, coupled with the prominence granted to judge-made law as opposed to legislative decree, made the common law more adaptable and hence more efficient than the civil law (Priest, 1977; Rubin, 1977). Systematic empirical evidence had now been presented to support this claim.

The new empirical findings offered by LLSV could therefore be seen as highly significant, provided they were accurate and proved robust over time. Yet, their accuracy was challenged on several grounds. At the most basic level of coding the relevant statutory law for shareholder and creditor rights, it was shown that the original dataset constructed by La Porta et al. (1998,

Chapter 2 in this volume) contained numerous errors (or, at least, highly questionable judgments on the values to be accorded to particular variables). When the data were recoded and the same regressions run with the corrected data, none of the results of the original 1998 'Law and Finance' study proved robust (Spamann, 2010, Chapter 7 in this volume).[2] In addition, the comparative methodology of the legal origin studies was criticized as problematic. If, as comparative legal scholarship maintains, functional equivalents are pervasive across legal systems, coding a specific set of rules or institutions selected from one system (such as US-orientated rules on shareholder protection) may be highly misleading, as it runs the risk of ignoring different yet functionally equivalent institutions in other legal systems (Pistor, 2000). Finally, legal scholars questioned the use of cross-sectional rather than longitudinal (that is, historical) data in the early legal origin studies (Armour et al., 2009, Chapter 10 in this volume). These studies show that company law and labor law (among other areas of law) have changed substantially, in both developed and developing countries, in the recent past. Moreover, legal changes across the common law/civil law divide often occur in tandem, with common law countries and civil law countries engaging in similar law reform processes. While these studies are so far confined to only a few countries given the difficulties of coding multiple processes of legal change across time for a larger sample, they still shed doubts on the far-reaching claims by LLSV concerning systemic differences in specific legal institutions. They also raise questions about the suggestion that the common law is uniquely committed to the protection of private property rights.

Other studies have challenged the limited time period in respect of which outcome data, such as financial development, were collected in the foundational legal origin papers. The data for stock market development used in the original 'Law and Finance' study, for example, are from 1993. To test the robustness of legal origin claims over time, Rajan and Zingales (2003, Chapter 14 in this volume) analysed stock market development prior to World War I. They claimed that cross-national differences in capital market liquidity and structure, associated by the legal origin literature with the later divide between France and Germany, on the one hand, and the UK and the US, on the other, did not exist at this time, a finding supported by business historians such as Hannah (2009). It would seem that the results achieved by the early and most highly cited legal origin papers were contingent on the sampling periods used in that research. By the same token, historical analyses have cast doubt on the claim that the common law has been consistently superior to the civil law, in terms of outcomes, over time (Milhaupt and Pistor, 2008). In response, the lead authors of the legal origin literature have challenged the accuracy of the early stock market data used by their critics (La Porta et al., 2008, Chapter 3 in this volume). At the same time, they have conceded that claims about the economic superiority of the common law are likely to turn out to be time-contingent. In a paper published in June 2008 they stated:

> As long as the world economy remains free of war, major financial crises, or other extraordinary disturbances, the competitive pressures for market-supporting regulation will remain strong and we are likely to see continued liberalization. Of course, underlying this prediction is a hopeful assumption that nothing like World War II or the Great Depression will repeat itself. If it does, countries are likely to embrace civil law solutions, just as they did back then. (La Porta et al., 2008: 327)

Law and Markets

If, as the historical perspective suggests, the way the legal system works to promote economic development is contingent on a benign economic environment, what exactly is the relation between law and markets? The legal origin literature does not address this question head-on. In common with the mainstream law and economics literature, it assumes that markets are, for the most part, self-forming and self-adjusting, and portrays law as an exogenous influence on pre-existing economic relationships. The legal system can improve economic outcomes by reducing transaction costs associated with exchange. An illustration of this effect is provided by an early paper by Andrei Shleifer and Robert Vishny, analysing corporate governance rules around the world, with a specific emphasis on emerging markets (Shleifer and Vishny, 1997). The paper argues that potential inefficiencies arise in capital markets from asymmetries of information between investors and managers. For investors to part with their money, they will demand either direct control of the firm's assets, or effective legal protection. Where the law is not effective, they will seek to take controlling stakes. Thus the willingness of investors to diversify their holdings across a number of companies in which they hold minority stakes, and hence the degree of liquidity of the market as a whole, will depend on the degree to which the legal system in a given country provides effective protection for shareholders' rights. By extension, the same argument applies to creditor rights: creditors are more likely to lend money to firms if the legal system provides them with protection against opportunism on the part of borrowers, for example by providing banks with means to enforce their security interests at low cost, or the power to put failing firms into bankruptcy. Still, the markets for firms and capital exist in an assumed state of nature even in the absence of law and legal institutions. Law's major function is to support these markets and enhance their efficiency. As we have seen, the original 'Law and Finance' paper (La Porta et al., 1998, Chapter 2 in this volume) found empirical evidence to support these claims. Yet as the legal origin literature has deepened and further studies have been carried out to test the limits of the initial findings, the idea of a linear relationship between legal protection of shareholder and creditor rights, on the one hand, and financial development, on the other, has had to be qualified.

Two recent papers illustrate the dynamic nature of the interplay between law and markets. Houston et al. (2010) show that strong legal protections for creditor rights are linked with higher economic growth, but also with an increased risk of financial crisis. Their analysis is consistent with the view that legal changes aimed at enhancing financial growth can have a number of sometimes competing and offsetting effects. Deakin et al. (2012), using time-series analysis, find that the strengthening of shareholder rights which occurred worldwide in the 1990s and 2000s had different effects depending on context. These legal reforms had a minimal observable effect on financial development in civil law countries, suggesting that reforms inspired by a common law model of shareholder rights had not worked well when diffused to civil law contexts, a finding consistent with earlier research on legal transplants (Berkowitz et al., 2003, Chapter 13 in this volume). Deakin et al. (2012) also report evidence of a positive impact of reform on the growth of financial markets in developing countries, but a link to financial instability and asset-price bubbles in developed, common law countries.

Despite the importance it accords to legal institutions in shaping financial outcomes, the legal origin literature has so far stopped short of claiming that law is in some way constitutive of market relations. From the perspective of law as a mechanism for reducing transaction

costs, more protection for shareholder and creditor rights is unambiguously better than less. This is consistent with a conceptual framework which assumes that market participants are rational actors, willing to fully internalize the costs of their actions in pursuit of individual gain. A different conception of the law–market relation, implicit in but still relatively unexplored within historical accounts of legal origin, is that law evolves endogenously in response to economic development (Ahlering and Deakin, 2007; Milhaupt and Pistor, 2008).[3] The legal system and the economy co-evolve, in a complex, mutually iterative relationship within which each of them preserves a certain degree of autonomy from the other. This implies that the law does not simply respond to the functional needs of market actors, any more than it directly shapes them; apparently exogenous shocks in the form of market crashes, on the one hand, or major new regulatory initiatives, on the other, are, in part at least, endogenously generated by the working out of tensions and contradictions at a systemic level. In this context, it would seem that the full implications for legal origin of evolutionary models of complexity and path dependence (Roe, 1995) have yet to be fully worked out.

Law, Social Ordering, and Economic Development

The legal origin literature started out with a narrow and specific claim: investor rights matter for corporate governance and financial market development, and some legal systems are better than others at developing and enforcing such rights. The field has now evolved well beyond this claim, to the point of identifying legal systems as foundational for the social ordering on which economic development depends. The contrast between central control and decentralized autonomy, state tutelage and individual freedom, and top-down regulation and self-regulation by market actors, runs through this literature. The legal origin literature is part of a debate on the appropriate role of the formal legal system and of the state more generally in the regulation of the economy in its modern form that goes back to Hayek's depiction of 'the road to serfdom' (Hayek, 1944). According to Djankov et al. (2003, Chapter 9 in this volume), with the debate about communism against capitalism now having firmly been resolved in favor of the latter, the debate can shift to comparison between systems that all claim to be capitalist. In this vein, the legal origin literature has morphed into a wider project of historical and theoretical research. Glaeser and Shleifer (2002, Chapter 1 in this volume) traced the origins of the difference between the common law and the French civil law back to the 12th and 13th centuries when juries began to emerge in England but France stuck to a system of court-appointed and centrally controlled judges. Djankov et al. (2003, Chapter 9 in this volume) argued that the character of legal systems was the result of policy choices along a hypothesized 'institutional possibility frontier' running between the two extremes of anarchy on one hand and dictatorship on the other. In this account, countries that face the threat of violence or anarchy will employ institutions that favor centralized control, whereas countries that experience peace and prosperity tend to choose decentralized means of social and legal ordering. Choices, once made, are highly path-dependent – they are hardwired into the political and social fabric and cannot easily be derailed by events, not even by revolution, the social and political upheavals associated with the process of industrialization, a country's transition from absolutism to republicanism, or its involvement in world wars. Legal origin can accordingly be understood 'as a style of social control of economic life (and maybe of

other aspects of life as well)' (La Porta et al., 2008: 286, Chapter 3 in this volume).

Legal origin theorists are not the first to develop a theory of social order and economic development in which law plays a major role. Weber (1978) and Hayek (1973) are only the most prominent among the social theorists who have attributed an important role to law in social ordering. What sets legal origin theory apart from these earlier accounts is its conception of legal origin as a hardwired determinant of social order.

The assertion that legal origin is outcome-determinative across time – literally over centuries – has not surprisingly been the subject of considerable discussion and criticism. It has been argued instead that socioeconomic development has deeply influenced the nature of common and civil law systems (see Stone, 1936, Chapter 4 in this volume, and Tunc, 1976, Chapter 5 in this volume). Moreover, in countries on the receiving end of the Western legal system, the legacy of colonialism, in particular the imposition of indirect rule, is associated with institutional development that is adverse to economic growth and development (Acemoglu et al. 2001, Chapter 12 in this volume). Others have suggested that the effectiveness of legal systems is a function not so much of the contents of legal rules – whether derived from common law or civil law – but of the process by which legal systems develop. Specifically, Berkowitz et al. (2003, Chapter 13 in this volume) show that countries that received their formal legal system by way of transplants have less effective legal systems than countries where the legal system evolved internally.

The legal origin literature has instead focused on England and France as the archetypes of the common law and civil law systems respectively (see Glaeser and Shleifer, 2002, Chapter 1 in this volume; and Djankov et al., 2003, Chapter 9 in this volume), and has used the results obtained from regression analyses with a larger cross-section of countries to support its claims. It is this empirical basis that the legal origin literature uses to validate its extrapolation from the stylized historical experience of only a few countries to the rest of the world. Thus the theory is derived primarily by way of induction from cross-sectional data to theoretical explanation. Weber operated in a similar vein: he identified a rational legal system as a critical ingredient for the emergence of capitalism by comparing conditions in the West with the rest of the world and finding that rational law was what the West had but the East did not. He too faced problems of selection bias in choosing what factors to look at. Yet this did not prevent him from correcting his suppositions on the basis of real world observations. He resolved the famous 'England puzzle' – the fact that the English legal system lacked the hallmarks he ascribed to a rational legal system, yet was the first country to industrialize – by suggesting that capitalism can be and is sustained by rather diverse sets of institutions, which are unlikely to converge notwithstanding similarities in the nature of capitalist enterprise across national systems (Weber, 1978). In contrast, the legal origin literature tends to idealize the market as a unique institutional form. Hayek's approach to law and legal theory also differs from legal origin in that he undertakes a much broader normative analysis of the origins of social order. He acknowledges that the 'spontaneous order' of the market and of society more generally is not an end in itself but a means for the attainment of individual liberty (Hayek, 1973). Even in Hayek's account, the legislature may therefore play a critical role in compensating for the limitations of self-ordering as a means of achieving that goal. By contrast, in the legal origin literature, free markets appear to be the only relevant goal. As La Porta et al. (2008, Chapter 3 in this volume) put it:

> the influence of legal origins on laws and regulations is not restricted to finance. In several studies (...) we found that such outcomes as government ownership of banks (...), the burden of entry regulations (...), regulation of labor markets (...), incidence of military conscription (...), and government ownership of the media (...) vary across legal families. In all these spheres, civil law is associated with a heavier hand of government ownership and regulation than common law. Many of these indicators of government ownership and regulation are associated *with adverse impacts on markets*, such as greater corruption, and higher unemployment. (emphasis added)

This passage demonstrates the narrowness of the empirical base and theoretical claims of the legal origin literature in comparison to earlier attempts to understand the role of law in economic growth and development. The function of legal systems is seen as the perfection of markets. The wider normative goals of either law or markets are not addressed. While personal liberty may be implied in the celebration of the market principle, there is no account within the legal origin approach of how markets sometimes limit personal liberty, or create economic hardship and deprivation, as widely documented in historical accounts (Polanyi, 1944), and demonstrated once more by the negative effects of the recent global financial crisis and social and economic development.

Legal origin theory has some considerable way to go in providing a theory of law and development that can fit what we know about the relationship between institutions and sustainable economic growth. Despite the range of empirical studies demonstrating a link between legal origin, market-orientated legal rules, and particular aspects of financial and labor market development, it has not been possible to demonstrate, using the same statistical techniques, a correlation between common law legal origin and a higher level of GDP growth (La Porta et al., 2008, Chapter 3 in this volume). Indeed, the growth 'miracles' of the postwar era all arose in civil law countries (Germany, Japan, South Korea, Indonesia, and China), with India being a belated exception, and one that is embracing the market principle only reluctantly, notwithstanding its common law roots (Cappelli et al., 2010). It would seem that while the law can be more or less conducive to market-based growth, depending on circumstances, unfettered markets do not always produce sustainable economic development.

Comments on the Readings

In an attempt to illustrate the richness of the legal origin literature, we have included in this volume what we regard as the major contributions of this literature and have paired them with critiques that highlight potential weaknesses in the data, empirical analysis, and conceptual framework. Such a selection is obviously the result of judgment calls; we have refrained from using citation counts as the criterion for selecting the papers, and instead focused on those contributions that we believe highlight the major contributions, but also the inherent limits of the legal origin literature. In addition, we have included some readings that reflect earlier debates on common and civil law in legal scholarship and legal pluralism to better situate legal origin in scholarship about law and development. These contributions have been grouped thematically.

The first part consists of three papers by legal origin theorists which set out the core hypotheses and findings of that body of work. Edward Glaeser and Andrei Shleifer's 2002 paper, 'Legal Origins', develops the argument for legal origin as an exogenous influence on

economic development, shaping the content of legal rules and the process of economic growth in a path-dependent way. This is followed by possibly the most influential of the empirical legal origin papers, the 'Law and Finance' paper published by LLSV in 1998. This paper describes the first datasets to provide evidence, in a systematic form, of cross-national variation in the legal protection of shareholder and creditor rights, and sets out econometric results demonstrating a link between legal protection and economic performance outcomes. Finally in this part we reproduce the 2008 paper published by La Porta, Lopez-de-Silanes and Shleifer, 'The Economic Consequences of Legal Origins', reviewing their own research and that of other contributors to the legal origin literature over the preceding decade, and assessing the academic and policy significance of that body of work.

The legal origin literature highlights distinctive features of different legal systems, in particular the roles of the state vs. markets, and of legislatures and regulators vs. judges in different legal systems. Critically, it suggests that these features have remained constant over time – without, however, fully explaining why that is. In contrast, comparative law scholars have vigorously debated the challenge of socioeconomic change to the distinct character of legal systems. Several of the arguments advanced by legal origin advocates and their critiques are reflected in these debates that precede the legal origin debate.

The papers included in the second part reflect some of these debates in comparative legal scholarship. Harlan Stone's article addressing the future of the common law in the United States was written in 1936 – the height of the New Deal legislation. He notes that the inherent conservatism of common law with its orientation towards past precedents was unable to keep up with the rapid pace of socioeconomic development since the mid 19th century. A greater role of the legislature was therefore inevitable. He calls for a reconciliation of common law skills with law that is responsive to socioeconomic change. André Tunc's article explains the methodology of the civil code in France in an address he made to an audience in one of the rare American offshoots of the French legal system, the law school of Tulane University in New Orleans. Tunc's paper notes that socioeconomic development posed a challenge to the purity of the French civil law system: the aspired completeness of the code, which was designed to cover all aspects of the *droit civil*, has given way to the proliferation of statutes and regulations outside the code. Moreover, the role of the judge has changed. Judges are no longer simply the 'mouth' of the code, but have proactively developed legal doctrine to respond to socioeconomic change. These changes notwithstanding, he still asserts that there is a distinct French legal methodology that has survived these changes. Pierre Legrand's paper argues that the distinctiveness of legal systems is not surprising and develops a theory of law that explains why. He views law as an expression of deep-seated practices and belief systems, or what he calls the mental map, or *mentalité*, of societies. Civil and common law systems rest on fundamentally different cognitive structures, which are re-enforced by social practices of which law is only one social subsystem. His theory supports the legal origin claim about the distinctiveness of common and civil law, but political economy is less important than the cognitive dimension of law in Legrand's approach.

In the next part we return to the legal origin literature. It contains two papers on data and methodology. Holger Spamann's 2010 paper, 'The "Antidirector Rights Index" Revisited', presents the results of the author's recoding of LLSV's original anti-director rights index, an exercise which casts doubt on the reliability of results from that paper which have been very heavily cited. In his paper 'Law and Finance: Common Law and Civil Law Countries

Compared', Michael Graff points out a number of inconsistencies in LLSV's construction and analysis of the anti-director rights and creditor rights indices, and argues that they cannot reasonably be interpreted as demonstrating the superiority of common law modes of financial regulation. He suggests that while the common law and civil law can be understood as providing different modes of economic governance, one is not clearly better than the other.

The fourth set of articles looks at the issue of legal origin and the evolution of legal systems. The first article to be reproduced is Simeon Djankov et al.'s paper 'The New Comparative Economics'. This argues that legal institutions reflect trade-offs between disorder and dictatorship. The compromises struck at critical points in the institutional development of countries influence subsequent political choices and the receptiveness of national systems to transplants from overseas. John Armour, Simon Deakin, Priya Lele and Mathias Siems' paper, 'How do Legal Rules Evolve?', presents the results of a longitudinal legal coding exercise for the company, bankruptcy and labor laws of five countries (France, Germany, India, the UK and USA), going back to the early 1970s. Their data reveal the considerable extent of legal change over time and the trend in all systems, whatever their legal origin, towards stronger protection for shareholders. Enrico Perotti and Ernst-Ludwig Von Thadden, in their article 'The Political Economy of Corporate Control and Labor Rents', explore the circumstances under which the concentration of financial wealth can induce demand from a financially-weakened middle class for laws which support labor rights. Their analysis suggests that strong labor laws are complementary to a prominent role for banks and larger investors within corporate governance.

In the fifth part, the focus shifts to the relationship between legal origin and other political and institutional factors in shaping long-run economic development. We first reproduce one of the seminal papers in the economics of institutions and development of the past decade, Daron Acemoglu, Simon Johnson and James Robinson's 'The Colonial Origins of Comparative Development'. This article stresses the importance of the initial conditions of colonization for understanding legal and economic development. It stimulated a major programme of research on the diffusion of institutions from developed to developing countries and the significance of this process for growth. In their paper 'Economic Development, Legality and the Transplant Effect', Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard analyse the reasons for the failure of legal transplants to take hold in many developing country contexts. Their study highlights the importance of endogenous institutional evolution in providing workable rules and the limits, in contrast, of strategies based on the adoption of codes and statutes from foreign legal systems with which host countries have little connection. This is followed by Raghuram Rajan and Luigi Zingales' paper, 'The Great Reversals'. This article argues that the level of financial development in a given country is a function of its political economy, and specifically of the opportunities provided to incumbents to oppose financial reforms which would lead to enhanced competition. In this approach, the key variable is the openness of a country to financial and trade flows, rather than its legal origin. Finally, Mark Roe's contribution on 'Legal Origins, Politics and Modern Stock Markets' also emphasizes the importance of politics for understanding the emergence of different legal institutions. He points to the impact of war, economic devastation and the rise of social democratic politics in continental Europe as critical determinants of modern financial markets. In this account, politics and ideological preferences are highly path-dependent. As a result, Roe argues, common law institutions inserted in social democratic environments might confront influences

that are adverse to the flourishing of these institutions and to the kind of markets they are meant to engender.

In the sixth and final part we introduce two pieces that challenge the centrality of Western legal systems in comparative legal and institutional analysis. The common vs. civil law divide uses formal law as developed in the origin countries of England, France and Germany to classify legal systems around the world. The justification for this is that the rest of the world was colonized by these three powers (or by countries they influenced, such as Spain in the case of Latin America) and received their formal legal orders from them. While true, this says nothing about the importance of the formal law derived from the West in other parts of the world. Even in Western countries, formal law is not the only mechanism of social ordering. Religion, social norms, customary law, indigenous practices, etc. co-exist with formal law, and in some parts of the world may be more important in ordering social affairs than formal law. There is a vibrant debate about 'legal pluralism' in legal, sociological and anthropological scholarship and some of these ideas are being picked up in behavioral economics and related work. Franz von Benda-Beckman gives a useful overview about this literature and in the course of this argument problematizes the concept of law, which in the legal origin literature is simply taken for granted. Last, but not least, we include Ugo Mattei's proposal for an alternative classification of legal systems that takes account of the plurality of law and legal systems at the global level. He divides legal systems into three clusters: political, professional, and traditional legal systems. The classification is based on an assessment of how legal systems operate, rather than the origins to which they can be traced. These two papers suggest that there is more than one way to compare legal systems around the world. By including them we hope to suggest ways in which the study of comparative legal systems might be broadened and deepened.

Notes

1. This is the count for the NBER working paper; the JPE version has 2339 citations (last checked 25 April 2011).
2. LLS corrected their original data in response to this challenge, but also inserted additional variables, which allowed them to revalidate their original findings. See the critical review of the recoding effort by Spamann (2006).
3. Theoretical antecedents for this view can be found in the writings of Montesquieu (1748) and Marx (1845).

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