

## Law, Finance and Development: Research Report

### Background

It is widely believed that institutions, including legal ones, matter for economic development. However, consensus disappears when points of detail are considered. What is the right institutional mix of laws facilitating private ordering (private law) and state-based regulation? How far are national systems locked into particular developmental paths by inherited legal-institutional structures? Should the experience of certain countries be used as a basis for global 'best practice', or should laws and regulations be fitted as far as possible to local conditions? More fundamentally, are legal institutions a precondition of economic development, or one of its consequences? The *Law, Finance and Development* project set out to investigate these questions, with specific reference to the relationship between law and finance.

A focus for the work was the 'legal origins' hypothesis (see La Porta *et al.*, 2008 for a recent restatement). This sees legal systems as having a long-run impact on patterns of economic growth. Countries whose legal systems have a common law origin are said to place a greater emphasis on freedom of contract and the protection of private property than those with civil law roots, which tend to favour an activist role for the state (Glaeser and Shleifer, 2002). Quantitative indicators have been used to chart the extent of cross-national variation in the content of laws governing the business enterprise and to establish correlations between legal and economic variables (Djankov *et al.*, 2003). Common law systems have been found to have more dispersed share ownership and more liquid and extensive capital markets (La Porta *et al.*, 1998), more highly developed systems of private credit (Djankov *et al.*, 2006), and more flexible labour markets (Botero *et al.*, 2004), than civilian ones. In part through the *Doing Business* reports of the World Bank, these findings have come to influence policy reform in 'dozens of countries' over the past decade (La Porta *et al.*, 2008: 326). Reforms to company and insolvency law have strengthened shareholder and creditor rights, while deregulation has been the predominant approach in labour law.

Influential as it is, the legal origins hypothesis is incomplete in various respects. From a theoretical perspective, the claim that legal origin is entirely exogenous, with its implication that the nature of a country's legal infrastructure is fixed at the point when it first adopts or has imposed upon it, through colonization or conquest, a particular type of legal system, may be questioned. An alternative hypothesis is that legal systems interact with economic and political structures at national level, and may be altered by them. They may also be affected by transnational legal influences such as harmonization and regulatory competition. Empirically, the datasets used to substantiate the legal origins hypothesis only provide (for the most part) cross-sectional evidence on the state of the law. Few primary legal sources are cited, raising issues of verification, and inconsistencies in the approach taken to coding have been identified.

The *Law, Finance and Development* project was conceived in order to address these issues. At the theoretical level, the insights of comparative law and political economy were to be put to use in engaging with the legal origins claim. At the empirical level, longitudinal measures of cross-national legal variation would be developed, making it possible to assess the relationship between legal and economic variables using time-series and panel-data techniques. Country-level case studies would complement the econometric analyses.

### Objectives

The following objectives were identified for the project:





















