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John W. Cioffi

D. Gordon Smith

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Legal Regimes and Political Particularism: An Assessment of the “Legal Families” Theory from the Perspectives of Comparative Law and Political Economy

*John W. Cioffi**

ABSTRACT: *The “legal families” theory of corporate law and ownership structures pioneered by Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny provides one of the most influential accounts of why “law matters” in shaping economic organization and outcomes. However, the empirical bases and theoretical logic of the theory contain serious flaws and limitations. First, as has been pointed out by a number of critics engaged in this revision, the legal origins literature contains numerous problematic characterizations of substantive law that expose the serious problems of quantitative operationalization of legal rules as a mode of comparative legal analysis. Second, the econometrics analysis of broad, cross-national patterns of legal and financial system characteristics departs from the theoretical and practical concerns of law as an academic and professional discipline focused on intra-systemic behavior. Third, the legal families theory is essentially an underspecified, path-dependent account of political economic development that is, at the very least, in logical tension with observable changes in law and financial system structures of both the past and present. Fourth, the methodology does not adequately distinguish between countries in which the rule of law and functional political and legal institutions are well-established (generally the advanced industrial countries) and those in which they are not (generally less developed countries (LDCs), often with significant post-colonial legacies). Given these flaws in, and limitations of, the legal families theory, the intuitively appealing thesis that law matters must be resituated in a more empirically persuasive and historically sensitive account of the relationship between law and politics. I speculate that any meaningful correlation between legal*

* Assistant Professor of Political Science, University of California, Riverside; Ph.D., University of California, Berkeley, 2002; J.D., Rutgers School of Law-Newark, 1990.

origins and economic outcomes is the product of politics in the first instance rather than law, and that legal families likely function as a proxy for different forms of political economic organization.

I. INTRODUCTION

The “legal origins” (or “legal families”) theory of corporate law and ownership structures pioneered by Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny (LLSV) has become one of most influential accounts of why “law matters” to economic organization and outcomes.¹ The literature written and inspired by LLSV seeks to explain significant variations in the ownership structures and financial market development of a wide range of countries around the world and has grown vastly in size and complexity. Their core contentions are well-known: legal systems around the world are largely derived from a discrete set of “legal families” and these origins have had a substantial and systematic influence on current national legal and, thus, financial structures. Anglo-American common law origins are associated with stronger minority shareholder protections and disclosure rules, and higher levels of equity finance. They are also correlated with dispersion of shareholding, the separation of ownership and control, securities market development, and higher rates of economic growth. Scandinavian, German, and French civil law traditions are generally correlated, in descending order, with weaker shareholder protections, greater financial opacity and opportunities for insider rent-seeking, and lower scores on economic outcome measures.

1. For LLSV’s direct contributions to this literature, see Rafael La Porta et al., *Government Ownership of Banks*, 57 J. FIN. 265 (2002); Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. FIN. 1147 (2002) [hereinafter La Porta et al., *Investor Protection*]; Rafael La Porta et al., *Agency Problems and Dividend Policies Around the World*, 55 J. FIN. 1 (2000); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Rafael La Porta et al., *The Quality of Government*, 15 J.L. ECON. & ORG. 222 (1999) [hereinafter La Porta et al., *Quality of Government*]; Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) [hereinafter La Porta et al., *Law and Finance*]; Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); see also Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430 (2008); Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LIT. 285 (2008) [hereinafter La Porta et al., *Economic Consequences of Legal Origins*]; Rafael La Porta et al., *What Works in Securities Laws?*, 61 J. FIN. 1 (2006) [hereinafter La Porta et al., *What Works in Securities Laws?*]; Rafael La Porta et al., *Judicial Checks and Balances*, 112 J. POL. ECON. 445 (2004); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997).

However, the theoretical logic and empirical bases of the legal origins theory have been subjected to withering criticism. The theory resurrected the problematic distinction between common and civil law traditions—long dismissed by many comparative legal scholars as over-simplified and a misrepresentation of how legal systems actually work—and presented the distinction as an important determinant of economic organization, financial development, and growth. It appealed to the intuitive belief that both history (including colonial legacies) and law matter in the course and relative success of economic development. It did so, however, by greatly simplifying the characterization of historical and juridical phenomena. On a more practical and policy-oriented level, the theory and the literature it spawned privileged finance—and market-driven finance in particular—within the wider terrain of political economic ordering and effectively promoted pro-shareholder and market enabling legal mechanisms as crucial foundations for the growth of equity finance, the dispersion of shareholding, and growth of the broader financial system and economic development.² The pro-finance ideological and policy thrust of this literature came at a time when financial crises were recurrent and increasingly serious. Now, these financial crises have culminated in a global financial collapse and a worldwide Great Recession.

I review four crucial weaknesses of the legal origins literature from the perspective of comparative law and political economy.³ First, commentators have criticized the LLSV work for numerous problematic or erroneous characterizations of substantive law that indicate serious problems of quantitative operationalization.⁴ These issues of characterization and coding of legal rules remain contentious and difficult to resolve. The challenges become even

2. In this sense, the legal origins theory, as an application of neo-classical micro-economics, lends itself to policy prescriptions supported by comparative statics. LLSV, however, generally leave these implications oblique and hedged by their acknowledgement that there is no single optimal juridical governance regime.

3. By “comparative political economy,” I refer to the study of the systemic interrelations between political power and institutions, and economic organization and practices. This conception of political economy is entirely distinct from the definition of the term as the use of economic theory and methods to study political phenomenon (though it by no means precludes the use of such approaches), a prominent example of which is the legal families literature itself.

4. *See, e.g.*, Priya P. Lele & Mathias M. Siems, *Shareholder Protection: A Leximetric Approach*, 7 J. CORP. L. STUD. 17 (2007).

greater when one seeks to account for changes in legal concepts, norms, and rules over time.

Second, these problems of measurement point to deeper and more intractable theoretical and practical criticisms of the legal origins theory. Measurement difficulties implicate issues that go beyond methodological concerns to the theoretical logic and substantive understanding of law, economic organization, and political economy. Difficulties in operationalizing legal and political characteristics into useful quantitative variables not only call the empirical findings into question, they also raise serious doubts about the appropriateness of large-*n* quantitative methodology in the study of legal rules and institutions as a mode of comparative legal analysis. The reduction of complex legal provisions, their even more complex interaction effects, and mechanisms (and effectiveness) of enforcement to numerical form is at best extremely difficult; at worst, it distorts available data in ways that undermine findings at the levels of individual country cases and of broader comparative analysis.

Third, the legal families theory presents an exceedingly and problematically deterministic and path dependent view of law, institutions, and economic performance. The theory maintains that legal structures are path dependent and have a predictable long-term influence on economic behavior. It follows that the theory depends empirically on the continuity of both legal and corporate ownership structures. However, the historical record casts doubt on the continuity of country-level stock ownership patterns and national legal frameworks, let alone on the relationship between the two. As Rajan and Zingales have shown, economic history contains a number of “great reversals” in financial system organization and shareholding patterns. While national economies cannot change the origin of their legal system, in some cases they have shifted between a market-based and bank-based financial system, and between diffuse and concentrated shareholding structures, while it could not change the origin of its legal system.⁵ Conversely, more recent sweeping reforms of financial market regulation and corporate governance around the world in the last two decades (and likely to accelerate in the near future) substantially undermine a theoretical argument based on path

5. Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 J. FIN. ECON. 5 (2003).

dependence and call into question many of the LLSV measures and codings.

Fourth, the legal origins theory does not adequately grapple with the differences between countries in which the rule of law and functional political and legal institutions are well-established (generally the advanced industrial countries) and those in which they are not (generally LDCs, which often have significant post-colonial legacies). One of the most ambitious aspects of the LLSV enterprise is its vast inclusiveness. But the same analytical approach, particularly one that takes the operation of law and legal institutions as fundamental in the causal analysis of economic outcomes, may not be appropriate across the entire spectrum of countries as classified by relative economic and/or institutional development. On the one hand, one of the intuitively appealing features of legal origins theory is that it purports to establish that “law matters” for economic organization and outcomes. On the other hand, if legal origins explain cross-national variation *despite* a large number of country cases in which the rule of law and the functionality of legal institutions is not, or is barely, established, it would seem to suggest that law does not matter. If this is true, it must be something else that matters.

This leads to a final speculation that, outside of the advanced industrial nations where the rule of law and legal institutions are generally well established, LLSV’s quantitative analyses—if they are in fact measuring anything—are likely indirectly measuring political differences rather than legal ones. The speculation is that the characteristics of different legal families at the foundation of legal origins theory reflect differences in political origins of states and polities that have had an enduring effect on economic, and particularly financial, development. Accordingly, the intuitively appealing thesis that law matters must be resituated in a more persuasive and historically sensitive account of the relationship between law and politics. These considerations frame a counter-hypothesis to the legal origins theory: any meaningful correlation between legal families and economic outcomes is the product of *politics*, in the first instance, rather than law. Legal families likely function as a *proxy* for different forms of political economic organization established by colonialism where they were imposed, or as elective affinity where foreign legal and governance frameworks were voluntarily adopted. The law-as-proxy relationship is

particularly likely where the rule of law has been and remains weak, and where legal institutions are relatively underdeveloped and lack autonomous capacity to articulate, apply, and enforce legal rules and standards.

II. WHY LEGAL ORIGINS?

The legal families theory is one of the rare instances where academic research has spawned a virtual cottage industry of scholars from an array of fields and subfields working to extend or critique it. This literature poses an initial question: Why has the theory become so prominent and influential? A number of factors help explain why the LLSV legal origins theory has become so visible and influential in a wide range of academic disciplines and debates.

First, it speaks to a wide range of debates cutting across a vast array of disciplines. The legal origins theory and analyses contributed to the study of financial regulation, corporate governance regimes, financial market development, ownership structures, state intervention in the economy, corruption and the rule of law, institutional capacity and development, and the relationships among law, legal institutions, and economic growth. Scholars spanning the fields of law, economics, management, political science, history, sociology, and geography could benefit from engagement with this body of work, giving it a large potential audience. But a potentially large audience does not explain why it in fact developed. This leads to a second important characteristic of the legal origins literature.

Legal origins theory has the intuitively and, perhaps just as importantly, professionally appealing characteristic of contending and adducing proof for the proposition that “law matters.” Not only do legal structures have an important and enduring impact on individual behavior, but legal history is also particularly important for explaining significant variations in economic organization and performance. The theory countered more doctrinaire versions of law and economics that elevated the post-Coase, Jensen, and Meckling contractualist paradigm and the private ordering of economic relations to the position of first principles—and often to the status of first and last policy prescriptions. Legal origins theory, emerging in the mid-1990s heyday of neo-liberalism and globalization-inspired convergence theories, pointed to a very different view of the role and efficacy of law, and therefore of politics. This no doubt appeals to many lawyers and legal scholars, who are quite naturally inclined to

think they study important and consequential, rather than epiphenomenal and ineffectual, aspects of social life. It also resonates with scholars and policy practitioners hailing from many disciplines and professional positions who are not reconciled or are deeply opposed to the absence of meaningful political and juridical agency implied by deterministic social science theories and the frequently *laissez faire* biases of much of law and economics.

However, the legal families theory remained firmly anchored in neo-classical economic theory in an era in which the discipline and theoretical apparatus of economics expanded its influence, empirical reach, and scope of substantive concerns. It emerged during a period (still ongoing despite a recent flurry of criticisms of academic economics) in which other social science disciplines increasingly appropriated the analytical framework of neo-classical economics and the tools of econometric analysis. Whether welcomed and praised as the harbinger of increasing theoretical and empirical rigor across the social sciences, or denounced as a case of ideologically-driven disciplinary imperialism, the undeniable fact is that, for better or worse, in recent decades economics has become the dominant intellectual current within the social sciences and policy circles. Accordingly, LLSV and the legal families theory became an especially visible example of a broader intellectual *zeitgeist*.

Further, the legal origins literature as developed by LLSV is an extraordinary achievement regardless of one's agreement with or rejection of the theory or of their findings. The vast and extraordinarily labor-intensive exercise of seeking to operationalize a huge number of legal, economic, historical, and political variables, use them to advance sophisticated modeling and quantitative analysis, and do this for a large number of industrialized and developing countries was—and remains—an exceptionally ambitious undertaking. This complex methodology reflected and embodied the trends across the social sciences, especially evident in political science, toward large-*n* quantitative studies as the gold standard of research and the increasing centrality of rational choice theories based on economic theory in a widening range of disciplines.⁶ By the

6. See, e.g., GARY KING ET AL., DESIGNING SOCIAL INQUIRY: SCIENTIFIC INFERENCE IN QUALITATIVE RESEARCH (1994) (one of the most influential volumes on comparative methodology in political science of the past thirty years and consistently advocating larger-*n* studies as necessary to buttress the validity of findings and causal inferences); cf. COMPARATIVE HISTORICAL ANALYSIS IN THE SOCIAL SCIENCES (James Mahoney & Dietrich Reuschmeyer

1990s, large-*n* statistical analysis had become a principal, if not dominant, method of social science research and approach to comparative analysis. In legal academia, the legal origins theory melded the growing influence of law and economics with the growing interest in the interdisciplinary study of law and legal institutions, even as it tended to provoke resistance from legal scholars wedded to traditional modes of legal analysis and immersed in the qualitative and discursive details of legal rules, doctrines, and theories within particular national systems.

The LLSV legal families project also benefited from fortuitous historical timing in a broader sense. The development of the legal origins theory formed part of a great wave of academic research related to the law, economics, and politics of financial systems, and corporate governance gathered momentum. The economic upheavals of the 1970s and 1980s precipitated a crisis of the postwar economic order at national and international levels. The manifestations of this crisis (or these crises) included the collapse of the Bretton Woods international monetary regime, stagflation, monetarism, deindustrialization, waves of mergers and acquisitions, and an explosive growth of international financial markets. These developments enhanced the structural power and economic centrality of finance, and implicated structures and practices of corporate governance as increasingly important to economic performance and public policy. By the 1990s, the financialization of the economy was not only a central dynamic of the liberal market Anglo-American political economies, it was also a core structural attribute of what was popularly (and loosely) identified as globalization in which neo-liberalism and the American economic model loomed as increasingly influential. This made the systematic study of finance and its relationships to law and politics increasingly important and attractive not only because it sought to understand the economic order (or orders), but also because it attempted to frame and empirically ground policy prescriptions in developed and developing countries alike in a way that consistently favored the

eds., 2003) (presenting a competing methodological approach based on careful historical and qualitative case study and small-*n* research); *RETHINKING SOCIAL INQUIRY: DIVERSE TOOLS, SHARED STANDARDS* (Henry E. Brady & David Collier eds., 2004) (staking out an intermediate position between the quantitative, statistically-driven large-*n* methods and qualitative, historically grounded approaches).

adoption and facilitation of market-driven financial and economic models.

The legal origins theory articulated in LLSV's work emerged as countries around the world began to reform their corporate governance and financial systems to spur economic adjustment and accommodate global financial flows. Countries pursued these goals in an effort to achieve higher growth rates. LLSV supplied policymakers with something often lacking in academic literature: the basis for framing clear policy prescriptions. The legal families theory purported to diagnose the juridical and institutional strengths and ills of many economies, while simultaneously pointing to a set of specific legal features and institutional arrangements conducive to the dispersion of equity ownership, the development of financial markets, and increased economic growth. The LLSV theory and analysis of comparative corporate governance and its relationship to relative economic success became highly influential not only within the academy, but also beyond it in national and international policy circles.⁷

In short, in many ways LLSV's timing was ideal for their extended foray into large-*n* econometric analysis of law and finance, and propitious for finding a broad audience for what they had to say and how they said it. However, as discussed below, the spread of financial system and corporate governance reform also posed problems for the legal origins theory. Ironically, legal reformers in many countries used LLSV's profoundly historically deterministic model of legal and economic structures as an intellectual justification for technocratic and often controversial structural reforms in securities and company law. The very fact that these reforms occurred undermined the deterministic and path dependent logic of the legal origins theory.⁸ The acceleration of legal and institutional change during an era of rapid financial globalization and neo-liberal

7. See, e.g., Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 463–64 (2006) (discussing the influence of the LLSV literature on policymakers).

8. Cf. MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT 166–67 (2006) [hereinafter ROE, POLITICAL DETERMINANTS] (critiquing the reduction of highly politicized legal structures to technical juridical fixes to technical economic problems).

reform made the path dependence of the legal origins theory appear increasingly anachronistic and self-contradictory.⁹

Reform posed a set of practical and theoretical challenges. If the legal origins theory was indeed correct, how could reform become so prevalent, and could it be effective? The near ubiquity of legal reform around the world underscored the paucity of politics in theories based on economics. What were the political dynamics of reform? How did reforms and antecedent rules and institutional arrangements affect economic performance and outcomes? These issues could not be captured in the correlational analysis and implicit comparative statistics of the legal origins theory. And if legal reform or financial system development could so rapidly shift in the contemporary era, might they not have experienced other periods of transformation in the past that would be inconsistent with the legal origins theory? Further, the politics of reform—and its substance—in the advanced industrial countries and in the developing and non-developing world could hardly be equated or analyzed in the same way. The tasks of reforming legal regimes in countries with a long tradition of the rule of law and well-established legal and regulatory institutions is hardly comparable to political challenges of *creating* legal regimes very nearly from scratch in less developed countries.

The reductionism of the LLSV treatment of legal rules as quantitatively operationalized variables and the breadth of their comparative analysis engendered substantial resistance by legal scholars. Lawyers and legal scholars may have been amenable to the finding that “law mattered” after all, but they typically have a far more nuanced understanding of how legal rules, their interpretation and application in practice, and enforcement mechanisms function as part of the systemic whole.¹⁰ Further, the systems of primary concern

9. See Ruth Aguilera & Cynthia Williams, “*Law and Finance*”: *Inaccurate, Incomplete, and Important*, 2009 BYU L. REV. 1413 (2009).

10. The “systemic whole,” in turn, can be conceptualized in multiple ways, ranging from the legal system narrowly defined as the body of formal legal rules adopted in a jurisdiction and the institutional means available for their interpretation, modification, application, and enforcement to a more expansive view of the political economy that encompasses political institutions, interest groups, social cleavages, forms of private economic organization, and market structures. The former framing is common to legal scholarship, which is understandably focused on legal rules and practices. The latter is the perspective cultivated in the field of comparative political economy and perhaps most explicitly in the “varieties of capitalism” literature. See, e.g., *VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE* (Peter A. Hall & David Soskice eds., 2001). Increasingly, scholars are attempting to integrate the analytical frameworks of comparative law

to legal scholars and professionals are narrower in institutional, jurisdictional, and political scope than the broad cross-national or global scope of large-*n* studies. Stated in terms of Holmesian legal realism, they are concerned with what courts (and other legal institutions and decision makers) will in fact do—that is, they are concerned with how legal rules will be used within the confines of a specific jurisdictionally defined and institutionally bounded context. The probability that country “X” will have a certain configuration of laws and institutional arrangements given a certain independent variable is distinct from the task of understanding the form and operation of law and legal institutions in specific national or sub-national cases. The way in which LLSV conceptualized legal rules and institutions in quantitative analysis thus does not accord with many lawyers’ and legal scholars’ understandings of how law works in practice. Moreover, it also fails to comport with their understandable focus on how legal rules are or are not enforced and how these rules influence behavior within the jurisdictional and institutional confines of particular legal systems. The LLSV use of large-*n* econometric analysis and traditional legal analysis in many

and comparative political economy. *See, e.g.*, JOHN W. CIOFFI, PUBLIC LAW AND PRIVATE POWER: THE COMPARATIVE POLITICAL ECONOMY OF CORPORATE GOVERNANCE REFORM IN THE AGE OF FINANCE CAPITALISM (forthcoming 2010) [hereinafter CIOFFI, PUBLIC LAW AND PRIVATE POWER]; PETER GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL: THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE (2005); CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW & CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT (2008); YVES TIBERGHEN, ENTREPRENEURIAL STATES: REFORMING CORPORATE GOVERNANCE IN FRANCE, JAPAN, AND KOREA (2007); Christopher A. Whytock, *Taking Causality Seriously in Comparative Constitutional Law: Insights from Comparative Politics and Comparative Political Economy*, 41 LOY. L.A. L. REV. 629 (2008). It is noteworthy that these works recognize the importance of both law and politics as interacting elements of dynamic reform processes that are at once highly particularistic, yet share common features. The pioneering work of Mark Roe also bridged the study of law and political economy by explicating the historical and political foundations of national corporate governance regimes and their impact on the diffusion of shareholding and the separation of ownership and control. *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994) [hereinafter ROE, STRONG MANAGERS, WEAK OWNERS]; Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993) [hereinafter Roe, *Some Differences in Corporate Structure*]; Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991) [hereinafter Roe, *Political Theory*]; *cf.* ROE, POLITICAL DETERMINANTS, *supra* note 8 (developing an analysis of comparative corporate governance based more on neo-classical principal-agent theories of law and economics and statistical analysis, and less on historically grounded political analysis).

ways reflected different ontological commitments and practical concerns.

III. MATH PROBLEMS—THE OPERATIONALIZATION OF LEGAL RULES

Joining this critical push-back against the legal origins theory are a number of economists and quantitatively-oriented scholars who took issue with the LLSV coding of legal variables and thus with their findings—both of which appear to display a consistent bias in favor of common law systems and the liberal market (i.e., Anglo-American) political economic model. A number of scholars have criticized LLSV and the legal origins theory for improper quantification of legal rules and concepts.¹¹ These criticisms undermine the very foundation of a fundamentally statistical endeavor. Holger Spamann, for example, recently undertook to systematically review and, where appropriate, revise the measures of the legal variables LLSV used in their 1998 article *Law and Finance*.¹² Reexamining the coding for the variables in LLSV's influential "antidirector rights index" (ADRI), Spamann found that thirty-three of forty-six measures needed to be changed. The necessary changes resulted in a substantial diminution of correlational results.¹³ The statistical significance of the common law-

11. See MARKUS BERNDT, GLOBAL DIFFERENCES IN CORPORATE GOVERNANCE SYSTEMS: THEORY AND IMPLICATIONS FOR REFORMS 17–18 (2002); REINIER R. KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 61 n.117 (2004); Udo C. Braendle, *Shareholder Protection in the USA and Germany—“Law and Finance” Revisited*, 7 GERMAN L.J. 257 (2006); Sofie Cools, *The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers*, 30 DEL. J. CORP. L. 697 (2005); Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan*, 3 EUR. BUS. ORG. L. REV. 765, 779 n.43 (2002); Lele & Siems, *supra* note 4; Mathias M. Siems, *Shareholder Protection Around the World (“Leximetric IP”)*, 33 DEL. J. CORP. L. 111 (2008).

12. Holger Spamann, *‘Law and Finance’ Revisited* (John M. Olin Ctr. for Law, Econ., & Bus., Harvard Law School, Discussion Paper No. 12, 2008); cf. La Porta et al., *Law and Finance*, *supra* note 1, at 1126–28 (presenting the antidirector rights index).

13. Spamann, *supra* note 12, at 14. The ADRI variables quantify national law regarding “one share, one vote,” “proxy by mail allowed,” “shares not blocked before the meeting,” “cumulative voting,” “oppressed minorities mechanism,” “pre-emptive rights to new issues,” “share capital required to call an extraordinary shareholder meeting,” and “mandatory dividend.” *Id.* at 20. Joined by Simeon Djankov, La Porta, Lopez-de-Silanes, and Shleifer have developed an alternative to the ADRI, Djankov et al., *supra* note 1, at 432–33 (presenting an anti-self-dealing index as the successor to the antidirector rights index), but this index has been criticized as even more problematic as a metric of legal variables. See Lucian A. Bebchuk &

civil law distinction disappeared with respect to the ADRI values or correlations with stock market size and shareholder dispersion—the two most important outcomes for the legal origins literature.¹⁴ Strikingly, using corrected ADRI values, the German legal family scored the highest mean, followed by the Scandinavian, common law, and French families, respectively.¹⁵ The rating of the quality of shareholder protection under American law fell from five to two.¹⁶

Lele and Siems criticize LLSV both for coding/quantification errors and, more importantly, for conceptualization problems that result in a failure to adequately account for shareholder decision-making power, shareholder power to remove directors, board composition, or director self-dealing.¹⁷ They suggest that the pattern of omissions from the ADRI variables and the way in which they were defined had a pronounced pro-U.S. bias that consistently tended to raise the rating of American law and systematically lowered the scores of countries, like Germany, that have different, though in many ways effective, shareholder protections.¹⁸ Rejecting the LLSV ADRI variable definitions and constructing an entirely new index from sixty variables traced over thirty-five years for the United States, United Kingdom, Germany, France, and India, Lele and Siems found that shareholder protections improved for all countries over the entire period.¹⁹ However, beginning in approximately 1985, the United States became a notable laggard with its shareholder protections virtually unchanged until the passage of the Sarbanes-Oxley Act and related regulatory reforms following the Enron-era corporate scandals.²⁰ Even then, the United States was found to provide the lowest level of protection of all the countries studied; Germany and France, virtually indistinguishable, were found to provide the highest.²¹ In a follow-up study extending the analysis to

Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1279 n.54 and accompanying text (2009) (presenting criticisms of the anti-self-dealing index).

14. Spamann, *supra* note 12, at 15–17.

15. *Id.* at 14. Moreover, the French family's lowest mean was not statistically significant.

Id.

16. *Id.*

17. Lele & Siems, *supra* note 4, at 18–21.

18. *Id.* at 20–21.

19. *Id.* at 30–35.

20. *See id.* at 31–32.

21. *Id.* at 31 fig.1.

twenty countries, including more from the developing world, Siems confirmed these findings and made the additional and surprising finding that *German* law is far closer to the international mean than the United States or the United Kingdom.²² Further, while many countries, particularly China, had converged on German law as measured by the index, the United States and United Kingdom had *diverged* from it.²³

Like the studies of LLSV before them, these studies do not, and perhaps cannot, adequately address the issue of enforcement. Enforcement is a notoriously difficult subject to study quantitatively, but this difficulty makes it no less critical to the description and assessment of a legal system.²⁴ Part of the reason that enforcement is difficult to quantify centers on the limitations of available data.²⁵ Another reason for the difficulty lies in the inherent challenge of measuring the different substantive and procedural elements that affect enforcement rates and effectiveness along with the widely varying forms of enforcement that coexist even within the same legal and governance system. Spamann expressly notes that superior enforcement mechanisms, both public and private, in the United States likely compensate for the deficiencies of its substantive law.²⁶ If included in the analysis, this greater enforcement capacity would presumably raise the rating of the effectiveness of shareholder protection under the law in the United States. Lele and Siems do include enforcement variables, but the definitions are derived entirely from formal characteristics of the law and these are incomplete.²⁷ They do not reflect, for instance, the differences in actual enforcement rates and practices, particularly private litigation, cross-nationally.²⁸

22. Siems, *supra* note 11, at 144.

23. *Id.* at 132.

24. See, e.g., John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229 (2007).

25. Data on litigation rates, even for a country as developed and as litigious as the United States, leaves much to be desired. Comparable cross-national data is virtually non-existent.

26. See Spamann, *supra* note 12, at 18.

27. For example, they do not code for class-actions (or functionally analogous collective actions), contingency fee arrangements, or critically important discovery rules and their application in civil litigation. See Lele & Siems, *supra* note 4, at 22–25.

28. The high propensity for litigious enforcement in the United States compared to other countries is treated at length in the literature on adversarial legalism. See, e.g., ROBERT A.

These studies lead to a possibility, disquieting to those who place hope in the efficacy of legal reform to alter and improve economic performance, that law does *not* matter after all. The countries and the legal families with the highest revised scores are not correlated with shareholder dispersion or stock market development. I leave to the side the problematic claims that “Berle-Means” corporations, with dispersed shareholding, larger numbers of publicly traded firms, and a high stock market capitalization relative to GDP, are economically desirable and confer benefits in excess of costs to the political economies in which they are prevalent. Yet, there are still substantial grounds that support the contention that law matters as an important influence on economic behavior, organization, and development.

The near-ubiquity and significance of pro-shareholder and market-enabling legal reforms around the world during the past twenty years suggest that law is an important influence on financial practices and economic development. These reforms have displayed a pronounced trend towards greater shareholder protection and transparency regulation—during the period of time when financial markets have exploded in size and holders of financial assets gained in political influence.²⁹ It is apparent that governments and interest groups believe that law matters enough to devote substantial political and actual capital to getting it changed. Nevertheless, it may be far easier to change formal law and use largely symbolic legal change as investor/finance-friendly signaling, than to build up regulatory or judicial enforcement capacities.³⁰ Powerful vested interests resist and

KAGAN, ADVERSARIAL LEGALISM: THE AMERICAN WAY OF LAW (2001); Robert A. Kagan, *Should Europe Worry About Adversarial Legalism?*, 17 OXFORD J. LEGAL STUD. 165 (1997).

29. See, e.g., GRANT KIRKPATRICK, CORPORATE GOVERNANCE: A SURVEY OF OECD COUNTRIES (Organizations for Economic Cooperation and Development, 2004), available at <http://www.oecd.org/dataoecd/58/27/21755678.pdf>.

30. Milhaupt and Pistor, for example, characterize the post-Enron and WorldCom passage of the Sarbanes-Oxley Act of 2003 in these terms, though they do concede that the law’s corporate governance provisions represent a potentially significant movement towards the federalization of state corporation law. MILHAUPT & PISTOR, *supra* note 10, at 56–60; cf. John W. Coiffi, *Revenge of the Law? Securities Litigation Reform and Sarbanes-Oxley’s Structural Regulation of Corporate Governance*, in CREATING COMPETITIVE MARKETS: THE POLITICS OF REGULATORY REFORM 60 (Marc K. Landy et al. eds., 2007) [hereinafter Coiffi, *Revenge of the Law*] (arguing that Sarbanes-Oxley was a more substantive and path-breaking law than many critics have allowed, though also finding it deeply flawed by political constraints that precluded more fundamental reforms of corporate boards, the reform of proxy voting

seek to neuter substantive legal changes and enforcement mechanisms that challenge their authority and access to rents. State actors may seek to maintain control over the institutions and mechanisms of enforcement by opposing the cultivation of private litigation causes of action and procedures, either out of concern over the potential abuses and inefficiencies of litigation, or in order to preserve an important power resource.

The politics—and political obstacles to effective reform—are likely to play themselves out somewhat differently in developed and developing countries. Viewed cross-nationally, there are diverse ways to enforce or otherwise vindicate legal norms that reflect the different ways in which economies are governed across different countries with divergent political economic models, legal traditions, and regulatory frameworks. Economically successful non-liberal or “coordinated” political economies not only rest on different institutional foundations and interest group configurations than liberal market economies, they also may develop institutionally rooted comparative advantages. These advantages induce broad resistance to reforms of areas as politically and economically sensitive as corporate governance and financial system regulation that might jeopardize these systemic strengths. In developing countries, constructing institutions of economic governance—be they regulatory agencies, courts, or private regulatory structures—with sufficient independence, competence, and integrity to carry out effective enforcement is one of the most difficult of political tasks, yet one of the most fundamentally important. This potential disjuncture between pro-shareholder legal reforms around the world and the difficulty of developing effective means of enforcing legal rules and shareholder rights points to a particularly serious problem for developing countries where legal institutions and the rule of law itself are weak.

The global salience of law and legal reform in the areas of financial system and corporate governance reform leads to a deeper set of problems with the legal origins theory, and even to the impressive efforts to improve on the quantitative analysis of law, governance, and finance. Quantitative analyses can be of enormous use in identifying (and sometimes debunking) broad patterns of

rules and role of institutional investors, the executive compensation practices, or reconsideration of legislative curbs on private litigation mechanisms).

political economic organization, legal structure, and economic development. On the other hand, they can also miss vitally important dimensions of how governance institutions develop and operate in particular political and social contexts. Perhaps inevitably, they present a formalist and functionalist conception of law and legal institutions that make them more amenable to operationalization and statistical analysis, but obscure how politics and legal practice determine the forms and functions at the base of the analysis. As one comparative legal scholar has remarked, “LLSV, for all their emphasis on legal origins, ultimately do not take the law seriously.”³¹ The theoretical and analytical approaches of comparative law and comparative political economy can help fill in the lacunae of quantitative studies as represented by the legal origins literature.³²

IV. LEGAL ORIGINS AND LEGAL FAMILIES AS A PROBLEM OF COMPARATIVE LAW

The legal families at the conceptual foundation of the legal origins theory are problematic from the perspective of comparative legal theory. On the one hand, broad classificatory schemes such as the basic distinctions between common law and civil law systems, religious and secular law, and more jurisprudential and philosophical distinctions between positive law and natural law, are long-established modes of comparison and analysis. They are quite deliberately constructed to simplify the intricacies of actual legal systems into more general categories that can be viewed as Weberian ideal types. Such categorizations render the particular more readily accessible and provide the conceptual bases for inferring and articulating generalizable theoretical and empirical propositions regarding law, legal systems, and their practical significance.³³ On the other hand, the problem with such classifications is that they tend to reflect rather thin and formalistic conceptions of law as a set of

31. Ralf Michaels, *The Second Wave of Comparative Law and Economics?*, 59 U. TORONTO L.J. 197, 201 (2009).

32. For a review of LLSV urging greater incorporation of qualitative data and political analysis, see Peter A. Gourevitch, *The Politics of Corporate Governance Regulation*, 112 YALE L.J. 1829, 1857 (2003) (reviewing MARK J. ROE, *POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT* (2003)).

33. See Jaakko Husa, *Legal Families and Research in Comparative Law*, 1 GLOBAL JURIST ADVANCES 4 (2001) (citing MAX WEBER, *ECONOMY AND SOCIETY* 1, 18–22 (1978)); DIRK KÄSLER, *MAX WEBER: AN INTRODUCTION TO HIS LIFE AND WORK* 180–84 (1988).

formal provisions and attributes that may tell us very little about how law and legal institutions develop and their practical significance in political and economic life.

Legal family groupings suffer from the same reductionism of ideal-typic classification schemes that tend to sever macro-level theory and its generalizations from micro-level realities and analysis.³⁴ Legal origins theory as developed by LLSV seeks to reconcile the macro- and micro-level dimensions of law through microeconomic theory and functionalist analysis.³⁵ In the process, they tend to fall into the traps of functionalism and formalism. LLSV break down the relevant law of each country and assess it according to a set of universal juridical benchmarking categories which allow them to measure legal protection for shareholders.³⁶ Once categorized, these categories are converted into variables for statistical analysis. LLSV classify the substantive law of different countries according to the dominant legal family on which the national legal system is based and score them with respect to these formalistic variables.³⁷ For example, LLSV's well-known and influential "anti-director rights index" is an aggregate measure of shareholder rights constructed with reference to six formal legal characteristics: (1) rights to mail-in proxy voting, (2) voting rights not constrained by share blocking (or mandatory deposit) rules, (3) cumulative voting or proportional representation rights, (4) oppressed minorities mechanisms, (5) preemptive rights, and (6) rights to call an extraordinary shareholders' meeting.³⁸ The data

34. Of course, LLSV and those extending the legal origins theory perform a further step of simplification of legal systems and their characteristics through numerical operationalization. See Mathias M. Siems, *Numerical Comparative Law: Do We Need Statistical Evidence in Law in Order to Reduce Complexity?*, 13 *CARDOZO J. INT'L & COMP. L.* 521, 533-38 (2005).

35. For an overview of LLSV's legal origins theory and method, and a wide-ranging summary of the micro- and macro-economic empirical findings related to their claims, see generally Rafael La Porta et al., *Economic Consequences of Legal Origins*, *supra* note 1.

36. *Id.* at 286.

37. *Id.* at 286-87.

38. LLSV form the antidirector rights index

by adding 1 when (1) the country allows shareholders to mail their proxy vote to the firm, (2) shareholders are not required to deposit their shares prior to the general shareholders' meeting, (3) cumulative voting or proportional representation of minorities in the board of directors is allowed, (4) an oppressed minorities mechanism is in place, (5) the minimum percentage of share capital that entitles a shareholder to call for an extraordinary shareholders' meeting is less than or equal to

aggregated from the country cases is then analyzed to ascertain the correlations between legal family of origin and the level of shareholder rights and protections.³⁹

Variations in national-level shareholder rights and protections are statistically correlated with legal families of origin.⁴⁰ Variations in legal protection for shareholders are also correlated with economic outcomes such as dispersed shareholding, ownership concentration and blockholding, returns to equity, and stock market capitalization.⁴¹ The legal categories of comparative analysis that produce the independent variables are justified by their effects on controlling agency costs within firm governance as predicted by economic theory. Not all aspects of legal systems are incorporated into the analytical framework. Nor are, for the most part, informal social relations nominally external to formal law. The criteria for inclusion are derived from microeconomic theory and principal-agent theory in particular. Certain types of legal rules compiled into the “anti-director rights index” are deemed important and worthy of operationalization, quantification, and analysis because they are presumed to affect the function of law in reducing agency costs of shirking and opportunism.⁴² These reductions of agency costs are identified *ex ante* as likely to influence the behavior of individual market actors.⁴³ This reliance on economic theory and the identification of specific types of legal rules incorporates aspects of formalist-functional approaches to comparative law into legal origins theory.⁴⁴

10 percent (the sample median), or (6) shareholders have preemptive rights that can be waived only by a shareholders’ vote.

La Porta et al., *Law and Finance*, *supra* note 1, at 1122–23, tbl.1. An “[o]ppressed minorities mechanism” provides for “judicial venue to challenge the decisions of management or of the assembly or the right to step out of the company by requiring the company to purchase their shares when they object to certain fundamental changes” *Id.* at 1122, tbl.1.

39. See generally Rafael La Porta et al., *Economic Consequences of Legal Origins*, *supra* note 1 (providing a summary and overview of literature).

40. *Id.*

41. *Id.*

42. *Id.*

43. See *id.* at n.3 and accompanying text.

44. Comparative law has long been both blessed and plagued by a profusion of theoretical schools and methodologies, each with their own strengths and weaknesses. Scholars frequently disagree as to what defines different theoretical approaches and despair of the incoherence of comparative law to the point of declaring it devoid of true theoretical content. I do not enter into these complex and arcane debates here.

The legal origins theory, like most economic theorizing, is deeply functionalist, and thus subject to the general critique of functionalism that has long been a staple of debate within comparative law.⁴⁵ Functionalist accounts of law rest on a set of assumptions that have been fiercely criticized and contested by other theoretical approaches to comparative law. Functionalist theory presumes that “the legal system of every society faces essentially the same problems, and solves these problems by quite different means though very often with similar results.”⁴⁶ The central question posed by the functional approach to comparative law is: “what legal norms, concepts or institutions in one system perform the equivalent functions performed by certain legal norms, concepts or institutions of another system?”⁴⁷ Underlying this functionalism is the conception of law as not merely purposive, but fundamentally instrumental, as a means of accomplishing *a priori* specified ends.⁴⁸ The bias in instrumental-functionalist approaches to legal comparison favors the analysis and finding of similar or analogous features across legal systems, rather than difference and divergence. The latter tend to be screened out in favor of a homogenizing normative orientation with significant policy implications.⁴⁹ In legal origins theory, the general categories of comparison are related to the common function of minority shareholder protection against rent-seeking by managers and controlling shareholders.⁵⁰

Differences enter the comparative analysis with respect to how well or poorly national legal systems embody given functional characteristics, yielding independent variables defined in formal legal terms, and how well they achieve the functional purpose of shareholder protection, as reflected by dependent variables

45. See Günter Frankenberg, *Critical Comparisons: Re-thinking Comparative Law*, 26 HARV. INT’L L.J. 411, 434–40 (1985); Jonathon Hill, *Comparative Law, Law Reform and Legal Theory*, 9 OXFORD J. LEGAL STUD. 101 (1989).

46. KONRAD ZWEIGERT & HEIN KÖTZ, *INTRODUCTION TO COMPARATIVE LAW* 34 (Tony Weir trans., 3d ed. 1998).

47. W.J. Kamba, *Comparative Law A Theoretical Framework*, 23 INT’L & COMP. L.Q. 485, 517 (1974).

48. *See id.*

49. Cf. Peer Zumbansen, *Comparative Law’s Coming of Age? Twenty Years After Critical Comparisons*, 6 GERMAN L.J. 1073, 1075–76 (2005) (discussing Frankenberg’s critique of functionalism as a perspective of false objectivity that obscures important dimensions of law and differences among legal systems).

50. See La Porta et al., *Law and Finance*, *supra*, note 1, at 1120–21.

measuring quantitative outcomes in shareholder diffusion, stock market capitalization levels, equity financing, or other similar variables. As both a conceptual and practical matter, this is an indispensable form of analysis. Most of us are interested in what laws and regulations *do*, in addition to (and sometimes to the exclusion of) what they *mean*.⁵¹ Functionalism allows for the establishment of a basis for comparability of different variables and cases. It simplifies the analytical framework of comparison so that larger numbers of cases can be accommodated. In this sense, functionalism in comparative law is conducive, if not essential, to large-*n* statistical studies of legal phenomena. However, this mode of inquiry may veil as much as it explicates, in both normative and empirical terms.

Framing functionality in terms of shareholder protection, let alone in terms of shareholder maximization, is neither normatively nor politically neutral. By so specifying the functional categories on which the comparative analysis is based, the legal origins literature has a potent normative and practical policy thrust consistent with the ideology and policy agenda of shareholder value.⁵² Even when LLSV describe legal families as historical legacies, their formalistic conception and operationalization of law and legal rules underlying the classificatory scheme militates against historical and political understanding of legal and institutional change. Seeking the objectivity of universal benchmarks, the approach dislocates legal systems, legal rules, and political economic arrangements from their temporal, political, sociological, and cultural contexts. The theoretical framework thus effectively depoliticizes the origins and course of development of a nation's legal system.⁵³ The "origins" of

51. Compare Frankenberg, *supra* note 45, with Zumbansen, *supra* note 49, at 1073–84 (criticizing functionalism for denigrating or ignoring the meaning and informal dimensions of law in its social context).

52. For an excellent discussion of shareholder value as ideological tenet and policy goal, see William Lazonick & Mary O'Sullivan, *Maximizing Shareholder Value: A New Ideology for Corporate Governance*, 29 *ECON. & SOC'Y* 13 (2000).

53. As expressed by Günter Frankenberg in a brutal and classic formulation:

The functionalist negates the interaction between legal institutions and provisions by stripping them from their systemic context and integrating them in an artificial universal typology of "solutions." In this way, "function" is reified as a principle of reality and not taken as an analytical principle that orders the real world. It becomes the magic carpet that shuttles us between the abstract and the concrete, that transcends the boundaries of national legal concepts, that builds the system of comparative law, the "universal" comparative legal science or "the general law."

national legal systems are reduced to a unitary and over-simplified assignation of predominant legal family—even where the foundations of national legal systems were imposed by an intermediating colonial power, as in the case of former Spanish dominions in Latin America designated as within the French legal family, or where they are the product of successive colonial powers or borrowings from a variety of legal traditions or families. The legal families at the base of the legal origins theory of law and finance are thus conceived and elaborated as *historically given* phenomena, yet, at least as presented in the work of LLSV,⁵⁴ legal families and their diffusion are largely ahistorical. However, the legal systems and traditions that form the origins of legal families emerged in specific jurisdictions under particular political and economic conditions, and were thereafter geographically diffused, either through coercive imposition (usually through colonialism) or by voluntary appropriation from their source country to another.

The use of formal legal categories as analytical tools or measures is often appropriate and useful, but such research methods and designs may screen out the historical and often intensely politicized processes of conflict, contestation, legal borrowing, and transplantation that determined the substance of these very categories in specific cases, processes that will continue to shape their development in the present and future. The development of legal systems, like that of states, unfolds over long periods of time, but the course of change often displays patterns of punctuated equilibrium or evolution. Political and economic change, crisis, and conflict are all ineradicably central to the dynamic of legal change and its effects on other dimensions of social organization and practice. Neither history nor politics can be treated so cavalierly as to become analytically epiphenomenal. Legal systems and bodies of law are often more accurately described as the products of *bricolage*, the recombination of borrowed elements appropriated from multiple legal traditions and systems, rather than direct lineal descendents of

Frankenberg, *supra* note 45, at 440. With respect to LLSV and much law and economics scholarship, one might extend Frankenberg's logic a step further to argue that reified categories that "transcend[] the boundaries of national legal concepts" are used to build a "universal" social science of general economic laws. *Id.*

54. See La Porta et al., *Law and Finance*, *supra* note 1, at 1117–18.

originating legal “families.”⁵⁵ (And this notion of *bricolage*, of course, does not fully engage the endogenous production of truly novel and innovative forms of legal and institutional change.) This is particularly so in domains such as securities regulation and corporate governance law. These overlapping areas of law are typically complex, nationally distinctive, and politically sensitive, yet are simultaneously exposed to increasing international market and political pressures. The regularity of financial crisis fosters waves of policy and legal change. The activities of transnational private organizations, ranging from markets to industrial firms and production networks, from financial institutions and markets to investment funds and shareholder advocacy groups, along with growth and increasing activities of multilateral institutions, create conditions that enable and intensify political and economic pressures for the diffusion of ideas and juridical concepts.⁵⁶

The combination of excess functionalism and formalism, such as that found in the legal origins theory, thus, may distort our understanding of how law and legal systems evolve, operate, and shape behavior in a given social or political setting. The functions fulfilled by legal rules and institutions are determined by political factors such as state institutional structure, interest group composition and alignments, partisan political conflict and competition, and by locally fashioned epistemic, ideological, and normative meanings of law. The purely instrumental economic effects of law are but one part of a much larger terrain in which law and its development are situated. As Peer Zumbansen notes,

By stressing the production of “solutions” through legal regulations, the functionalist dismisses as irrelevant or does not even recognize that law also produces and stocks interpretive patterns and visions of life which shape people’s ways of organizing

55. See JOHN L. CAMPBELL, INSTITUTIONAL CHANGE AND GLOBALIZATION 69–74 (2004) (developing a theory of institutional change through *bricolage*). Campbell’s theory of institutional change via *bricolage* does not explicitly address or seek to explain legal development, but the dynamic of appropriation and recombination lends itself particularly well to law where professionalization of jurists and transnational experience in legal practice often foster familiarity with and enable borrowing of foreign legal concepts and mechanisms.

56. See, e.g., Holly J. Gregory, *The Globalization of Corporate Governance, Part 1*, GLOBAL COUNSEL, 52 (Sept. 2000); Holly J. Gregory, *The Globalization of Corporate Governance, Part 2*, GLOBAL COUNSEL, 51 (Oct. 2000); cf. CAMPBELL, *supra* note 55, at 163–67 (arguing that multilateral organizations have had limited effects on diffusion and implementation of neo-liberal ideas and policies).

social experience, giving it meaning, qualifying it as normal and just or as deviant or unjust.⁵⁷

Conversely, law as a discourse, institutional environment, and as a determinant of other political and economic institutional arrangements may constitute the meaning and alter the conduct of social, political, and economic activity.⁵⁸

Two further fundamental difficulties arise from comparative functionalism once law is considered as a component of a national political economic regime. First, the contextualization of law in divergent institutional and political contexts may result in legal rules fulfilling different or multiple functions that are simply not detected when using a conceptual approach and methodology that imposes uniform functional categories. What law *means* to actors in a particular social and institutional context may have a significant impact on what it *does*, i.e., the ways in which it shapes behavior.⁵⁹ Legal theory stretching back at least as far as legal realism and well represented in law and society scholarship on the “law in action” has long focused on precisely these kinds of issues.⁶⁰ The analysis of the practical, cognitive, and ideological effects of law is thus a valuable part of what Theda Skocpol described as “the dialectic of meaningful actions and structural determinants.”⁶¹ However, such substantive and theoretical concerns typically favor the use of qualitative “thick description” or analytic narratives over quantitative analysis in order to discover how the embedding of law in social and institutional contexts influences the impact of law on the perceptions and behavior of individuals and groups.⁶²

57. Zumbansen, *supra* note 49, at 1076 (citing Frankenberg, *supra* note 45, at 438).

58. *See id.*

59. Cf. Rogers M. Smith, *Political Jurisprudence, The “New Institutionalism,” and the Future of Public Law*, 82 AM. POL. SCI. REV. 89 (1988) (discussing the theoretical development of sociological institutionalism and its potential to integrate normative and structural understandings of social and political phenomena, including law).

60. Indeed, the seminal work of Berle and Means and J. Willard Hurst’s later pioneering socio-legal work on law and the rise of the large corporation can be seen as foundational to this theoretical perspective on law. *See* ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932); JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES* (1970).

61. Theda Skocpol, *Sociology’s Historical Imagination, in* VISION AND METHOD IN HISTORICAL SOCIOLOGY 1, 4 (Theda Skocpol ed., 1984).

62. For two excellent examples of the use of analytical narratives in the study of comparative corporate governance, see GOUREVITCH & SHINN, *supra* note 10 (employing a mixed methods approach using both analytical narratives and statistical analysis), and

Second, a legal rule, principle, or concept may reflect and reconcile conflicting norms that likewise may go undetected and otherwise be devalued by a simpler, more reductive functional analysis. Fiduciary duties in corporate law have a shareholder protection function, but also may embody managerialist understandings of corporate control. Likewise, labor codetermination laws in Germany and many other European countries not only serve a legitimizing function for private enterprise and the corporate form, but they also play a role in structuring the broader national labor relations and production systems.⁶³ Other areas of corporate law, such as fiduciary obligations and rules governing board structure and meetings, may reflect the necessary normative and functional accommodation of labor representation on the supervisory board and on works councils that complicates the assignation of a specific function to parts of a complex legal framework. Codetermination law and other aspects of corporate law more generally may run counter to narrow short-term shareholder interests, but they may also serve efficiency enhancing ends. The legitimizing function served by protection of employee or other stakeholder interests may reduce potentially costly social and political conflict (or other more costly forms of government intervention into firm affairs).⁶⁴ Likewise, given complementary institutional arrangements,⁶⁵ such rules may help create comparative advantages in certain industries and markets.⁶⁶ Functionalist analyses can address

MILHAUPT & PISTOR, *supra* note 10 (using a form of analytical narratives to present “institutional autopsies” of financial and corporate governance crises).

63. See Kathleen Thelen, *Why German Employers Cannot Bring Themselves to Dismantle the German Model*, in UNIONS, EMPLOYERS, AND CENTRAL BANKS 138–69 (Torben Iversen, Jonas Pontusson & David Soskice eds., 2000).

64. See generally KATHLEEN A. THELEN, *UNION OF PARTS: LABOR POLITICS IN POSTWAR GERMANY* (1991); Wolfgang Streeck, *Co-determination: After Four Decades*, in SOCIAL INSTITUTIONS AND ECONOMIC PERFORMANCE: STUDIES OF INDUSTRIAL RELATIONS IN ADVANCED CAPITALISM 137 (Wolfgang Streeck ed., 1992) [hereinafter Streeck, *Co-determination*].

65. Complementary institutions are those whose coupling makes them more economically efficient than either would be in isolation. See, e.g., Peter A. Hall & David Soskice, *An Introduction to the Varieties of Capitalism*, in VARIETIES OF CAPITALISM, *supra* note 10, at 1.

66. This is a key claim of a large and influential body of comparative political economy scholarship. See, e.g., *id.*; Gregory Jackson, *Corporate Governance in Germany and Japan: Liberalization Pressures and Responses During the 1990s*, in THE END OF DIVERSITY? PROSPECTS FOR GERMAN AND JAPANESE CAPITALISM 261 (Kozo Yamamura & Wolfgang Streeck eds., 2003); Gregory Jackson, *The Origins of Nonliberal Corporate Governance in*

these sorts of complications in determining the roles law plays in social and economic life, but to do so they must view legal rules and institutions within their larger institutional and historical contexts. The irony underlying this treatment of law in the legal origins theory, and much functionalist analysis based on economic theory, is that along the way to concluding that law matters, the theoretical and analytical framework does not take law itself seriously.

Law is a system of normative rules that is not only the product of the historical interplay of exogenous and endogenous political and economic forces, but constitutive of political and economic arrangements. Law and legal systems, if they are anything more than a formalistic Potempkin village of provisions without effective enforcement or compliance, have their own semi-autonomous internal logic that plays a significant role in constituting the institutional environment in which political and economic action occurs. The more robust the rule of law is in a given political system, the more important this constitutive role of law will be. Two implications flow from this observation. First, comparative law would benefit from approaches to the study of comparative political economy that focus on the institutional logic and historical development of complex political economic systems. The two fields naturally complement one another, but remain largely distinct and autonomous to the disadvantage of each. Second, countries and their legal systems must be distinguished for analytical purposes on the basis of their relative institutionalization and robustness of the rule of law before anything can be said regarding the effects of law on economic organization and other outcomes. These two subjects are discussed in the following sections.

Germany and Japan, in THE ORIGINS OF NONLIBERAL CAPITALISM: GERMANY AND JAPAN IN COMPARISON 121, 169 (Wolfgang Streeck & Kozo Yamamura eds., 2001); Wolfgang Streeck, *On the Institutional Conditions of Diversified Quality Production*, in BEYOND KEYNESIANISM: THE SOCIO-ECONOMICS OF PRODUCTION AND FULL EMPLOYMENT 21 (Wolfgang Streeck & Egon Matzner eds., 1991); Sigurt Vitols, *Varieties of Corporate Governance: Comparing Germany and the UK*, in VARIETIES OF CAPITALISM, *supra* note 10, at 337. For an analysis of the role of legal norms and methods in underpinning different “varieties of capitalism,” see Katharina Pistor, *Legal Ground Rules in Coordinated and Liberal Market Economies* (European Corporate Governance Inst., Working Paper No. 30, 2005), *available at* <http://ssrn.com/abstract=695763>.

V. COMPARATIVE POLITICAL ECONOMY AND LEGAL-
INSTITUTIONAL ANALYSIS

Comparative political economy should have a deep affinity for comparative legal analysis. More specifically, the historical institutionalist school of comparative political economy has much to gain from comparative law.⁶⁷ Unfortunately, law has not taken up the central position in the study of political and economic institutions that its role in social life would justify.⁶⁸ Political science as a field has largely marginalized the study of law to its own periphery.⁶⁹ Legal scholars can hardly avoid politics and routinely enrich their work with political analysis, but historical institutionalist theory and empirical work seldom influence the thinking and work of academic legal analysis.⁷⁰ At least in advanced industrial economies, law plays an important role in ordering economic activity and constituting institutions—including the corporation—that shape the identities, interests, and strategies pursued by economic actors and groups. Indeed, one of the major contributions of the legal origins literature is the consistent argument that differences in legal

67. Historical institutionalism is a large and varied literature containing numerous conflicting theoretical approaches. For theoretical works summarizing historical institutionalism as a theoretical framework in comparative political economy, see CAMPBELL, *supra* note 55; STRUCTURING POLITICS: HISTORICAL INSTITUTIONALISM IN COMPARATIVE PERSPECTIVE (Sven Steinmo, Kathleen Thelen & Frank Longstreth eds., 1992); Coling Hay & Daniel Wincott, *Structure, Agency, and Historical Institutionalism*, 46 POL. STUD. 951, 951–57 (1998); Paul Pierson & Theda Skocpol, *Historical Institutionalism in Contemporary Political Science*, in POLITICAL SCIENCE: THE STATE OF THE DISCIPLINE 693 (Ira Katznelson & Helen V. Milner eds., 2002); Kathleen Thelen, *Historical Institutionalism in Comparative Politics*, 2 ANN. REV. POL. SCI. 369 (1999). This literature also has a branch focused exclusively on the United States known as American political development. See generally KAREN ORREN & STEPHEN SKOWRONEK, *THE SEARCH FOR AMERICAN POLITICAL DEVELOPMENT* (2004).

68. For an earlier plea to incorporate law in institutionalist theory, see Smith, *supra* note 59, at 89–108. Unfortunately, Smith's proposed theoretical and research agenda was not widely embraced.

69. The sub-field of public law has been reduced, in the main, though not entirely, to the study of judicial behavior and the study of courts in policy areas.

70. For prominent exceptions integrating comparative political economy within legal scholarship, see Pistor, *supra* note 66; MILHAUPT & PISTOR, *supra* note 10; Peer Zumbansen, *Varieties of Capitalism and the Learning Firm: Corporate Governance and Labour in the Context of Contemporary Developments in European and German Company Law*, 8 EUR. BUS. ORG. L. REV. 467 (2007), available at <http://ssrn.com/abstract=993910>; Peer Zumbansen & Daniel Saam, *The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capitalism*, 8 GERMAN L.J. 1027 (2007).

rules produce significant variation in economic organization and outcomes.⁷¹

Law also plays an important role in structuring politics in a multitude of ways and on multiple levels: constitutional law, legislation and statutory law, regulatory rule-making and processes, case law, and the roles and powers of courts and other adjudicatory bodies. Law is both the product of politics and part of the political machinery that produces it. This dual role makes law and regulation a vital component of the institutional arrangements that define much of the public and private spheres—and the relations between them. Disentangling the relationship between law as product and law as political architecture is at once difficult and necessary, and it is made more difficult, if not impossible, by ahistorical theories. Hence, a historically grounded approach to political analysis is particularly useful to the study of how law functions as part of the political economy.

Historical institutionalism as a theoretical approach to the study of political economy represented a response by scholars during the 1980s and 1990s to older theories of interest group politics and structural functionalism, as well as to some characteristics and currents of rational choice theory.⁷² From interest group theory, and later from rational choice theory, historical institutionalism appropriated the concepts of group competition for scarce resources, instrumental calculation, and strategic action.⁷³ Structural functionalism contributed the conception that the polity and political economy are comprised of systematically interacting institutional components. The structural relations among these institutional features allocate power and resources asymmetrically, and thus privilege some groups over others in ways that contribute to distinctive trajectories of development over time.⁷⁴ This aspect of structural analysis problematizes interests and preferences that form a

71. See, e.g., La Porta et al., *Economic Consequences of Legal Origins*, *supra* note 1, at 285–89.

72. For a classic summary of historical institutionalism, contrasting it with the rational choice and sociological variants of the “new institutionalism,” see Peter A. Hall & Rosemary C.R. Taylor, *Political Science and the Three New Institutionalisms*, 44 *POL. STUD.* 936 (1996). For an early statement of the intellectual and research agenda of historical institutionalism, see *STRUCTURING POLITICS*, *supra* note 66, at ix–xiii.

73. Hall & Taylor, *supra* note 72, at 937; see also THELEN, *supra* note 64, at 373–74 (discussing the relationship between rational choice and historical institutionalism).

74. Hall & Taylor, *supra* note 72, at 937.

critical point of distinction between historical institutionalist theory and the assumptions of rational self-interest at the foundation of neo-classical economics. For historical institutionalists, interests and even interest group identities are the endogenous product of institutional arrangements, including legal and regulatory frameworks.⁷⁵ Different groups form and their structure, scope, composition, and political and economic strength vary under divergent institutional and legal arrangements.⁷⁶ The incentives and opportunity structures they face differ across institutional contexts and as a result of their internal differences.⁷⁷

As a consequence, actors and groups may want very different things from the political and legal systems. Actors and groups can seek to maximize many sorts of benefits—wealth, status, security—and they can seek to maximize them over different time frames. Political and economic actors direct instrumental strategic action towards the pursuit of interests that have themselves been influenced by the legal and institutional environment that defines the available means to rationally pursue them (including group formation). Social values may play an important role in determining preferences within this universe of endogenous preferences, ideas and cultural norms. However, these subjective and contextually contingent interests may be pursued with ruthless and calculating efficiency appropriate to an institutional environment that privileges certain groups, interests,

75. See CIOFFI, PUBLIC LAW AND PRIVATE POWER, *supra* note 10, at ch. 2; CAMPBELL, *supra* note 55, at 145–46, 174–75, 185–86.

76. See generally Hall and Taylor, *supra* note 72, at 937–41; Kathleen Thelen, *Historical Institutionalism in Comparative Politics*, 2 ANNUAL REVIEW OF POLITICAL SCIENCE, 369–404 (1999); STRUCTURING POLITICS: HISTORICAL INSTITUTIONALISM IN COMPARATIVE PERSPECTIVE (Sven Steinmo, Kathleen Thelen, and Frank Longstreth eds., 1992); PETER A. HALL, GOVERNING THE ECONOMY: THE POLITICS OF STATE INTERVENTION IN BRITAIN AND FRANCE 233, 276–80 (1986); Wolfgang Streeck and Phillippe C. Schmitter, *Community, Market, State—and Associations? The Progressive Contribution of Interest Governance to Social Order*, in PRIVATE INTEREST GOVERNMENT: BEYOND MARKET AND STATE 1, 1–29 (Wolfgang Streeck & Phillippe C. Schmitter eds., 1985); cf. Theda Skocpol, *Bringing the State Back In: Strategies of Analysis in Current Research*, in BRINGING THE STATE BACK IN 3–42 (Peter B. Evans, Dietrich Rueschemeyer & Theda Skocpol eds., 1985); JOHN ZYSMAN, GOVERNMENTS, MARKETS AND GROWTH, chs. 1–2 (1983) (interests and adjustment strategies of private actors and groups shaped by institutionally-defined state capacities to develop and implement interventionist policies).

77. See, e.g., Christine Mahoney, *The Power of Institutions: State and Interest-Group Activity in the European Union*, 5 EUROPEAN UNION POLITICS 441 (2004); Gary Marks & Doug McAdam, *Social Movements and the Changing Structure of Political Opportunity in the European Union*, 19 W. EUR. POL. 249 (1996).

and strategies over others. The social and institutional environment of a competitive marketplace fosters and reinforces the form of rational self-interest and economic utility maximization found in most economic theory. From this vantage point, the market order and its associated conceptions of norms and interests is a special case, rather than a universal description of the essential attributes of socio-economic relations. In sum, institutions are inherently biased in their allocation of power and authority, the formation of interests, and their influence in constituting the normative appropriateness of behavior. Law tends to reinforce these biases by constituting or buttressing institutions.

Institutions not only constitute and shape power relations, they are, of course, the historical products of political conflicts, bargains, and consensus that then tend to become path dependent. Law provides a particularly important example of both the historical processes of development and of path dependence. One of the primary values of a legal order is its relative stability, whether one describes that value in terms of making credible commitments, establishing functional organizational routines, or the protection of particularly important norms. The stability of the legal order derives from both power relationships and cognitive, or ideational, factors.

First, legal rules and institutions mobilize bias.⁷⁸ They tend to empower, structurally entrench, and often enrich certain groups over others. Legal structures thereby tend to secure their own persistence and reproduction by creating asymmetries of power that benefit groups with a material interest in maintaining legally legitimated and privileged access to state power to enforce their claims.

For example, once corporate governance law tipped in favor of managerial interests in the late-nineteenth century United States (a consequence of American federalism and prevailing doctrines of constitutional law), managers had increased discretionary power over the resources of large corporate firms to reinforce their legally secured positions against both labor and holders of financial capital.⁷⁹

78. Cf. E.E. SCHATTSCHEIDER, *THE SEMISOVEREIGN PEOPLE: A REALIST'S VIEW OF DEMOCRACY IN AMERICA* 65 (1960). Later institutionalist theory built on Schattschneider's seminal formulation by focusing on the constitutive role of institutional arrangements on individual and group identities and interests.

79. See, e.g., ROE, *STRONG MANAGERS, WEAK OWNERS*, *supra* note 10; ROE, *POLITICAL DETERMINANTS*, *supra* note 8; Roe, *Political Theory*, *supra* note 10; Roe, *Some Differences in Corporate Structure*, *supra* note 10.

Successive political backlashes against managerial insulation, most notably during the New Deal, the post-Watergate 1970s, and the post-Enron period of reform during the early to mid-2000s, only partially undermined or reversed these legal and institutional advantages in corporate governance, while pension and labor laws tended to reduce the threat these constituencies posed to the authority of managers.⁸⁰ Conversely, where stakeholder governance became enshrined in law, as in Continental Europe and to some extent Japan, these arrangements, however incomprehensible to the general public in their myriad details, were substantially locked in by the interest group politics that corporate governance law informed and shaped.⁸¹

Second, law is inherently normative and this has political and sociological ramifications. Law, at least in functional democratic political systems, is a repository of social values, or, to use Katarina Pistor's term, "ground rules."⁸² Where this is the case, the path dependence of law reflects not only the potentially pathological and dysfunctional lock-in effects of institutions, but the stability of a society's underlying ideological commitments to identifiable normative understandings (and at times aspirations). Even in its driest most technical manifestations, and corporate governance law is in many respects dry and technical, it embodies not only the concretization of interest group bargaining and political

80. John W. Cioffi, *Restructuring "Germany Inc.": The Politics of Company and Takeover Law Reform in Germany and the European Union*, 24 LAW & POL'Y 355 (2002); John W. Cioffi, *The State of the Corporation: State Power, Politics, Policymaking, and Corporate Governance in the United States, Germany, and France*, in TRANSATLANTIC POLICYMAKING IN AN AGE OF AUSTERITY: DIVERSITY AND DRIFT 253 (Martin A. Levin & Martin Shapiro eds., 2004); John W. Cioffi, *Building Finance Capitalism: The Regulatory Politics of Corporate Governance Reform in the United States and Germany*, in THE STATE AFTER STATISM: NEW STATE ACTIVITIES IN THE AGE OF LIBERALIZATION 185 (Jonah Levy ed., 2006) [hereinafter Cioffi, *Building Finance Capitalism*]; John W. Cioffi, *Corporate Governance Reform, Regulatory Politics, and the Foundations of Finance Capitalism in the United States and Germany*, 7 GERMAN L.J. 533 (2006); Cioffi, *Revenge of the Law?*, *supra* note 30, at 60.

81. See, e.g., John W. Cioffi & Martin Höpner, *The Political Paradox of Finance Capitalism: Interests, Preferences, and Center-Left Party Politics in Corporate Governance Reform*, 34 POL. & SOC'Y 463 (2006) [hereinafter Cioffi & Höpner, *The Political Paradox of Finance Capitalism*]; John W. Cioffi & Martin Höpner, *Das Parteipolitische Paradox des Finanzmarktkapitalismus: Aktionärsorientierte Reformen in Deutschland, Frankreich, Italien und den USA* [*The Political Paradox of Finance Capitalism: Shareholder Reform in Germany, France, Italy, and the USA*], 47 POLITISCHE VIERTELJAHRESSCHRIFT 419 (2006) (F.R.G.) [hereinafter Cioffi & Höpner, *Political Paradox: Shareholder Reform*].

82. Pistor, *supra* note 66, at 2.

maneuvering, but implicit or explicit normative and ontological beliefs about the world.⁸³ Once in place, legal rules tend to be invested with the imprimatur of the state and are often endowed with legitimacy by virtue of being legal.⁸⁴ Stripping legal rules and principles out of their broader normative, institutional, and economic contexts inevitably defines them in the thinnest of terms and distorts their meaning and function through excessive abstraction and formalism. Law is placed outside of politics and history. Accordingly, its origins and the recursive processes of legal and institutional change are obscured along with law's practical import.

As noted above, our understanding of law and legal systems, especially in comparative perspective, benefits from greater historical grounding and an explicit recognition of the ways in which the regulatory effects of legal rules and norms are embedded in and informed by their social and institutional context. This kind of analysis, however, favors small-*n* qualitative studies richer in narrative, nuance, and detail than can be captured by large-*n* quantitative methods. Qualitative approaches to research and analysis may trade off the parsimonious elegance and claims to generalizability of well-designed statistical studies and economic models for a fuller description of how legal and political economic systems operate and develop, but the trade-off goes both ways. Large-*n* quantitative analysis suffers from its own problems, namely that "the more cases scholars include in a study, the less likely they are to grasp the full range of information pertinent to understanding

83. More prosaically, perhaps, the influence of law in creating incentives to form certain types of organizational structures, such as the publicly traded corporation, and to pursue specific economic strategies, such as financially-driven management and restructuring, reaches down indirectly yet deeply into the micro-level of individual and collective behavior. As theorized by scholars of organization theory and sociological institutionalism, personnel within complex bureaucratic organizations that develop in a given legal environment commonly routinize tasks and orient behavior to scripts and norms of appropriateness that tend to have considerable resilience in the absence of external disruption. For a review, see, for example, THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS ch. 1 (Paul DiMaggio & Walter Powell eds., 1991). For an application to corporate management and governance, see NEIL D. FLIGSTEIN, THE TRANSFORMATION OF CORPORATE CONTROL (1993).

84. For a brilliant empirical study elaborating on this self-legitimizing character of law, see William Forbath, *The Shaping of the American Labor Movement*, 102 HARV. L. REV. 1111 (1989); see also WILLIAM E. FORBATH, LAW AND THE SHAPING OF THE AMERICAN LABOR MOVEMENT (1991) (studying the impact of the courts and labor law on the evolution of American "business" unionism).

those cases.”⁸⁵ It would be foolish to dispense with one mode of research and analysis or the other, but it is essential to understand their respective limitations.

Studies can draw on both modes of inquiry to good effect, as a number of recent major works on comparative corporate governance have done. Mark Roe, for example, has combined political history, economic theories of principal-agent problems, and statistical analysis in elaborating his political theory of comparative corporate governance. He has focused on political conflicts between right and left parties and between labor and capital as the driving forces of structural change in law, finance, and ownership.⁸⁶ Roe has argued that where the political left is politically strong, or where anti-financier populism is both prevalent and empowered by the structure of the state, shareholders are unable to secure effective legal means to constrain rent-seeking by labor and managers.⁸⁷ Shareholders thus tend to adopt blockholding strategies of control that impede the development of diffuse shareholding, the separation of ownership and control, and liquid securities markets.⁸⁸ Under this analysis, law matters, but it serves as an intermediate, rather than as an independent, variable.

Peter Gourevitch and James Shinn use a combination of large-*n* statistical techniques, institutional typologies of coordinated and liberal market economies appropriated from the “varieties of capitalism” literature, institutional theories of veto point politics, and qualitative analytical narratives to advance a coalitional theory of cross-national differences in corporate governance regimes.⁸⁹ Corporate governance law and regulation will vary cross-nationally—and change over time—depending on the interest group or interest group coalition that prevails in political struggle over corporate governance policy and lawmaking.⁹⁰ Where shareholders are

85. Gregory J. Kasza, *Quantitative Methods: Reflection on the Files of Recent Job Applicants*, in PERESTROIKA! THE RAUCOUS REBELLION IN POLITICAL SCIENCE 421, 425 (Kristen Renwick Monroe ed., 2005); see also Siems, *supra* note 34, at 521–40 (cautioning that statistical analysis of law and legal institutions is subject to substantial error and incompleteness).

86. See, e.g., ROE, POLITICAL DETERMINANTS, *supra* note 8.

87. *Id.* at 1–5.

88. *Id.*

89. See GOUREVITCH & SHINN, *supra* note 10.

90. See *id.* at 23, 59–67, tbls.2.3 & 4.1.

politically victorious, either alone (rather unlikely) or in alliance with managers or labor, they are likely to secure policies and laws conducive to securities market development and the dispersion of shareholding into the classic Berle-Means separation of ownership and control.⁹¹ Where shareholders lose to an alliance of labor and managers, for example, a bank-centered financial system will likely persist and shareholding is once again likely to remain concentrated in blockholding patterns within a “corporatist compromise” underlying the coordinated market economies identified by the varieties of capitalism literature.⁹² These interest group alignments and their respective interests vary cross-nationally, and these differences are powerfully shaped by the legacies of institutional arrangements within the state, firm, and markets.⁹³

Yves Tiberghien employs both statistical measures of bureaucratic autonomy and process tracing to explain the politics of corporate governance reform in response to the globalization of financial markets and capital flows.⁹⁴ This framework focuses even more on the political and policy-making agency of state actors, and thus relies on structural characteristics of state bureaucracies (and thus to some extent on cross-national differences in public law) in explaining the character and extent of pro-shareholder reforms. The ability to successfully reform corporate governance and financial market regulation is substantially determined by the institutional insulation of bureaucrats from short-term political pressures.

These studies are noteworthy in the ways they depart from and/or supplement statistical methodology and microeconomic theory that characterizes the legal origins literature. They implicitly or explicitly problematize the transparency, rigor, and precision of numbers in the study of something so complex, socially embedded, and often maddeningly ambiguous as law. These problems do crop up in the legal origins literature, most directly in the problems of quantification of its core legal and institutional variables as pointed out by a number of critics. Yet, this means that the legal origins literature tends to be analytically limited by the time-bound correlational snapshots it produces of complex and dynamic legal and

91. *See id.* at 61–63, tbls.2.3 & 4.1.

92. *Id.* at 64–65.

93. *Id.* at 28–29, 284–85.

94. *See* TIBERGHIEU, *supra* note 10.

economic systems.⁹⁵ The political economy approaches to the subject of corporate governance mentioned above grapple in their own way with the important problem of stability and change, which, in an age of reform and political economic crisis, is a matter of preeminent concern.

VI. LEGAL ORIGINS AND THE POLITICAL ECONOMY OF PATH DEPENDENCE AND REFORM

Theorization of the “stickiness” or path dependence of institutional arrangements, which may include legal and regulatory structures, is one of the strengths and accomplishments of the “new institutionalisms” in economics, political science, and sociology, but it is also one of their weaknesses.⁹⁶ Though recent scholarship has sought to address the problem of institutional and policy development,⁹⁷ much institutionalist theory and analysis is far more compelling as a way to explain stability than change. Likewise, legal origins theory, despite its exceedingly thin conception of law and institutions, is deeply and profoundly path dependent. Some of the developmental paths implicit in its attention to the colonial roots of many national legal systems stretch back for centuries. Path dependence is important to the study of political, legal, and economic phenomena, but it is not eternal or over-determining.

The path dependence of the LLSV contention that legal origins, often in the distant past, determine current states of financial development and corporate ownership patterns yields two distinct weaknesses. First, without historical grounding, LLSV are left with correlations without convincing mechanisms of causation to buttress their claims. Second, to some extent LLSV were historically unlucky. Just as they began to publish their work on the effects of legal origins, a wave of corporate governance and securities law reforms swept much of the world. If national corporate governance regimes

95. Capturing longer-term developmental trends and dynamics poses extraordinarily difficult problems of data gathering and quality that must be overcome before engaging in credible longitudinal and time-series analysis. Given extant controversies over data and operationalization within the legal origins literature, and the decline in the availability and quality of historical data going back in time, many of these problems are unlikely to be resolved satisfactorily.

96. See Peter A. Hall & Rosemary C.R. Taylor, *Political Science and the Three New Institutionalisms*, 44 *POLITICAL STUDIES* 936 (1996).

97. See, e.g., CAMPBELL, *supra* note 55.

and their legal components are so deeply path dependent, how could they have changed so quickly, over so much of the world, and in some cases repeatedly? In short, what we know of the recent and more distant history of financial systems and corporate capitalism casts doubt on LLSV's causal claims concerning the long-term influence of legal families.

In their article, *The Great Reversals*, Raghuram Rajan and Luigi Zingales advanced one of the most devastating critiques of the legal origins theory and its findings.⁹⁸ Rajan and Zingales note that in 1913 the major national economies in Continental Europe were far more financially developed than the United States (as measured by bank deposits and stock market capitalization as a percentage of GDP, share issues, and number of listed firms).⁹⁹ The traumatic economic shocks and upheavals of the two World Wars and especially the Great Depression triggered a political process of financial autarky that tightly constrained international capital flows and repressed financial market activities in order to create the structural conditions necessary to develop broad welfare state social insurance programs.¹⁰⁰ The post-war Bretton Woods monetary regime then institutionalized and entrenched this semi-closure of financial systems and sustained the broad trend towards social democracy across most of the industrialized countries.¹⁰¹ However, this transformation of the international economy and the political economies of the industrialized countries that fashioned it does not explain the variation across countries even during this period. From 1929 to 1980, the once robust financial markets and equity-driven finance of most civil law European countries and Japan contracted, while they rebounded in the common law-based United States and the United Kingdom. Rajan and Zingales attribute this divergence in post-war financial development to the greater state-sanctioned cartelization of finance during the period owing to the relative ease of regulatory capture of more centralized states.¹⁰² Only the

98. Rajan & Zingales, *supra* note 5.

99. *Id.* at 6–9.

100. *Id.* at 37–38.

101. Though they note that Keynes was among the architects of the Bretton Woods regime, Rajan and Zingales do not discuss the importance of the fact that the closure of national financial markets also facilitated policies of Keynesian demand management by removing the threat of capital flight in response to inflationary policies. *Id.* at 38–39.

102. *Id.* at 42–43.

breakdown of the original Bretton Woods system unleashed market forces that would erode these domestic cartels and state controls on finance and spur the belated development of financial markets around the world.¹⁰³

In this telling, the role of law—and legislation in particular—remains somewhat ambiguous, but its most salient function and effect is the repression of market finance. This would still make law and regulation an important subject in the study of financial development and corporate governance regimes.¹⁰⁴ The focus of theory and research shifts from seeking to demonstrate why common law systems arguably have fostered the growth of securities markets and the dispersion of shareholding, to explaining how and why so many non-common law systems developed in ways that thwarted these developments.¹⁰⁵

However, this leads to an objection to the Rajan and Zingales analysis. They appear to naturalize the Berle-Means firm and large, highly liquid securities markets. Absent the pernicious efforts of would-be private sector rent-seekers, governments, and state bureaucrats, this is how capitalist economies will develop. However, that capitalist economies will naturally or spontaneously develop the Berle-Means paradigm is unlikely and implausible. There are too many agency problems and too much volatility in the liberal market financial and corporate governance model to cavalierly declare it to be a natural outcome of market processes. This suspicion is supported by the fact that liberalizing legal reforms and the epochal growth of international financial markets during the past twenty to thirty years have not necessarily transformed many national financial systems and/or corporate governance practices.

It would also be an astonishing coincidence that most countries did not develop the liberal market paradigm. Unless the liberal market model is both natural and extremely fragile (which may be plausible in light of the financial crises of the past two decades and especially after the events of 2007–2009), Rajan and Zingales's analysis requires us to believe that all these countries successfully repressed the natural course of capitalist development.

103. *Id.* at 43.

104. *Cf. id.* at 41 (checks on policymaking by independent courts have a significant influence on regulatory and financial developments in the United States).

105. *Id.* at 42–43.

Regardless of the merits of the political explanation Rajan and Zingales offer for these outcomes,¹⁰⁶ their empirical findings pose a direct challenge to the legal origins theory. The logic of the LLSV argument is that legal origins set the basic structure of law and legal institutions in countries to which foreign legal families are exported, and that these structures continue to exercise a consistent influence on the law-taker countries' financial and corporate governance systems. This presumes that the countries of legal origin and destination have similar financial orders soon after the period of legal system transplantation (i.e., weak financial markets, little equity finance, and few publicly traded firms). Feeble financial markets and shareholder rights at the time of origin result in feeble markets and protections decades (or centuries) later. However, Rajan and Zingales marshal compelling evidence that, in the early twentieth century, Germany and France, two of the leading legal sources for the diffusion of their respective legal families, had highly developed market-driven finance systems, as did Japan (which appropriated much of the German legal model).¹⁰⁷ This finding appears to directly contradict the logic of path dependence on which the legal origins thesis rests, and suggests the need for an alternative political explanation for cross-national and inter-temporal variation.¹⁰⁸

A second serious empirical challenge to the path dependent logic of the legal origins theory is that there have been striking trends in corporate governance reform around the world over the past two

106. Rajan and Zingales argue, albeit rather tentatively, that decentralized law making through judge-made law and precedent characteristic of common law countries was less prone to capture than more centralized legislative functions of civil law systems. *See id.* at 42–43. This argument is unpersuasive. Even if state policymaking was captured by financial interests in Western Europe and Japan in the post-1929 or post-1945 period, that has nothing to do with the decentralization of common law rule formation. The post-war era witnessed the rise of the administrative state and regulatory bureaucracies in all these countries which could and regularly did override common law rules and doctrines. Some other political explanation is necessary to explain the outcomes.

107. *Id.* at 14–16, 39–41.

108. A number of scholars have attempted to develop political explanations of cross-national variation in financial system and corporate governance structures. *See, e.g.*, ROGER M. BARKER, CORPORATE GOVERNANCE, COMPETITION, AND POLITICAL PARTIES: EXPLAINING CORPORATE GOVERNANCE CHANGE IN EUROPE (forthcoming Jan. 2010); CIOFFI, PUBLIC LAW AND PRIVATE POWER, *supra* note 10; GOUREVITCH & SHINN, *supra* note 10; ROE, POLITICAL DETERMINANTS, *supra* note 8; TIBERGHEN, *supra* note 10.

decades.¹⁰⁹ Encompassing changes in both securities and company law, corporate governance reforms have consistently favored the expansion of shareholder rights and protections in securities regulation and corporate law. Corporate governance law and regulation across the major industrialized countries have undergone substantial re-regulation, reflecting efforts by political and economic elites to foster the development of domestic financial markets, financial services, and market-driven economic restructuring beginning at the firm level.¹¹⁰ This is consistent with Rajan and Zingales's finding of increased market development after the early 1980s and arguably demonstrates a contemporary "great reversal"—at least in law and regulation.¹¹¹

Once again, these developments undermine the legal-empirical premises and path dependent logic of the legal origins theory. Established legal structures and traditions do not appear to have

109. See, e.g., ORG. FOR ECON. CO-OPERATION & DEV., *CORPORATE GOVERNANCE: A SURVEY OF OECD COUNTRIES* (2004) (reviewing trends in corporate governance reform, particularly after the Enron-era corporate scandals and stock market crashes).

110. See generally TIBERGHIE, *supra* note 10; Cioffi, *Building Finance Capitalism*, *supra* note 80 (comparing contemporary reform and the emergence of "finance capitalism" in the United States and Germany); Cioffi & Höpner, *Political Paradox: Shareholder Reform*, *supra* note 81; Cioffi & Höpner, *The Political Paradox of Finance Capitalism*, *supra* note 81 (examining center-left political parties' increased emphasis on corporate governance reform in Germany, France, Italy, and the United States); John W. Cioffi, *Governing Globalization? The State, Law, and Structural Change in Corporate Governance*, 27 J.L. & SOC'Y 572 (2000) (describing cross-national trends in the development of corporate governance regimes in the United States, United Kingdom, Germany, France, and Japan).

111. In many countries, changes in market development, shareholder dispersion, and proportions of publicly traded corporations have not been commensurate with the degree of legal change. This gap between legal change and economic change may also undermine, or at least require modification of, the law matters thesis and the presumption that Berle-Means corporations, large stock markets, and high levels of equity finance are economically optimal. Law may still matter—a lot—as an enabling factor in the market-led transformation of finance and corporate governance, but only as part of broader institutional arrangements of the national, and increasingly the international, political economies. In some countries with non-liberal forms of political economic organization, the broader institutional arrangements create comparative advantages that are inconsistent with these characteristically liberal market financial and corporate forms. See Hall & Soskice, *supra* note 65, at 1; Peter A. Hall & Daniel Gingerich, *Varieties of Capitalism and Institutional Complementarities in the Macroeconomy: An Empirical Analysis* (Max Planck Inst. for the Study of Societies, Discussion Paper 04/5, 2004). Thus, even when controlling for cyclical market conditions, they experience at best modest change when laws are changed to encourage equity investment and stock market development. Further, this great reversal in favor of markets and shareholders has now entered a period of profound uncertainty as it confronts the grim realities of the global financial crisis that emanated from the United States beginning in 2007 and gained catastrophic momentum in 2008.

constrained reform in countries where we would have least expected them according to the legal origins theory. Common law and civil law countries and countries from all legal families have participated to a significant degree in this wave of pro-market and pro-shareholder reforms. Even if the legal origins theory had some explanatory power with respect to past cross-national variations in corporate governance law, those national legal frameworks have been substantially transformed in many cases. Whether or not the legal origins theory held through the 1980s or early 1990s becomes a largely academic question; proliferating legal change calls the lasting effects of legal families into question, while also continuously undermining the current accuracy of LLSV's coding of legal variables.

If the path dependence logic of the legal origins theory is rejected, the question is once again raised: does law matter? The answer is probably a qualified yes, though the question must be approached and answered differently depending on if it is directed at the developed or developing countries. In the advanced industrial countries, where the rule of law is firmly established and legal institutions are well-developed and capacious, law almost certainly "matters" to economic organization, practices, and outcomes (though it likely matters and functions in ways that depart from the simple and straightforward principal-agent, transaction costs theories underlying the legal origins literature). In the less developed countries, where the rule of law, legal institutions, and state capacity are typically much weaker, differences in legal origins may well correlate with some significant variations in finance, corporate ownership, and economic outcomes, but these differences are more likely the consequences of the political and institutional legacies of colonialism, rather than variation in legal families or even contemporary legal rules.¹¹²

112. I do not address cases in which foreign law was copied or appropriated in whole or in part as a voluntary policy choice by the adoptive country. The politics of legal and economic development, such as in Japan's purported adoption of German law in the nineteenth century, are not comparable to the colonial experience and cannot be analyzed in the same terms.

VII. RULE OF LAW, COLONIAL LEGACIES, AND LEGAL ORIGIN AS
POLITICAL PROXY: THE DEVELOPED-DEVELOPING COUNTRY
DISTINCTION

A serious methodological problem of the legal origins theory is the analytical treatment of developed and undeveloped countries in the same manner. A central logical contradiction emerges as a result: LLSV find that law matters where there is little or no effective law. If this is not simply some spurious statistical artifact, the correlation suggests that the relationship between legal families and economic outcomes is not the causal effects of legal rules on behavior and organization, but one of legal history serving as a proxy for some other political characteristics that have a more direct influence on financial development and forms of corporate governance. Developing countries are particularly important for the legal origins literature, not only because of the vital practical significance of economic development, but also because of the relationship between developing countries and legal families in LLSV's research design. Seeking to avoid endogeneity problems, the legal origins theory looks to the legal systems of developing countries in the post-colonial era as examples of exogenous imposition.

Thus, if developing countries are not truly comparable to the developed countries, and in particular the countries that exported their legal systems via colonial expansion, LLSV have not addressed the endogeneity problem they set out to solve. Rather than solving that problem, they have created another and arguably more serious methodological problem of comparing proverbial apples and oranges. If the legal origins theory cannot adequately measure and control for rule of law issues, the validity of the resultant empirical work is undermined. After all, one of the impressive and attractive features of the LLSV body of work is its comprehensiveness. It covers an at times astonishing number of country cases. However, if the methods used are not reliable to analyze the rule of law, and thus the role of law, in many developing countries suffering from pervasive and serious state incapacity and corruption, then the aggregate statistical findings decline in reliability as well. Even if the theory and analysis would work for country cases with more developed industrialized political economies and better institutionalized legal systems, there are relatively few rich "mother" countries covered in the studies and many more developing countries among their more problematic putative offspring.

The necessity of addressing issues of enforcement in any analysis of the effects and efficacy of law leads LLSV to include control variables concerning the quality of government and legal institutions.¹¹³

Both the current quality of government, including the judiciary, and its inverse, corruption and state inefficiency, must be incorporated into the analysis if the measures are to be anything more than an exercise in formalism. The imposition (or in a number of cases voluntary adoption) of a legal system based on a foreign legal family is an element of the political history of a country and according to LLSV their findings established it as an important one.¹¹⁴ Politics and history enter into the analytical framework through the side door, so to speak, into a theory that is essentially non-political and not well suited to explain how or why states came to differ in their competence, effectiveness, and integrity.

There are two fundamental problems with this approach. First, the rule of law, quality of institutions, and even corruption are notoriously imprecise and slippery concepts. Fierce, and likely endless, debates revolve around the rule of law as a concept, norm, and measure.¹¹⁵ Likewise, governmental quality is inherently difficult to conceptualize, assess, and quantify. Normative disagreement over what constitutes quality in public governance complicates the task of conceptualization. The extraordinary complexity of state functions, even restricting the inquiry to legal and regulatory activities directly related to corporate governance, pose daunting measurement problems.¹¹⁶ As Mathias Siems has noted, quoting Albert Einstein no less, scholars of comparative law should “[m]ake everything as simple

113. See La Porta et al., *Investor Protection*, *supra* note 1, at 1154–58. Earlier articles raise a number of political questions in conceptual and historical terms. See La Porta et al., *Quality of Government*, *supra* note 1; La Porta et al., *What Works in Securities Laws?*, *supra* note 1 (shifting the focus of the legal origins analysis from corporate law to securities regulation).

114. See La Porta et al., *Law and Finance*, *supra* note 1, at 1118–19, 1126.

115. See Stephan Haggard, Andrew MacIntyre, & Lydia Tiede, *The Rule of Law and Economic Development*, 11 ANN. REV. POL. SCI. 205 (2008) (review of different conceptions and measures of the rule of law and the problems they pose for empirical and quantitative analysis). Haggard et al. note that beyond disputes over the conceptualization of the rule of law and its relationship to formal state institutions, *informal* social institutions and norms also often inform the meaning and robustness of the rule of law in practice. *Id.* at 221–22. This further complicates the problems of conceptualization and empirical analysis.

116. For a critique and partial defense of quantitative methodology applied to law and governance, see Siems, *supra* note 34.

as possible, but not simpler.”¹¹⁷ It is not surprising, therefore, that the critiques of LLSV’s measures have focused on their coding and metrics for specific substantive and procedural rules in different countries, but have largely avoided the bramble bushes of state capacity and integrity, along with the strength of the rule of law.

Second, leaving aside governmental competence, capacity, and efficiency, corruption (often used as a proxy for measuring strength of the rule of law) is both an extremely serious problem in developing (or non-developing) countries and it is by its nature largely hidden from view. Participants are hardly eager to disclose the extent or means of their corruption.¹¹⁸ Hence, metrics of quality of government are based on survey data based on subjective impressions of corruption, transparency, adjudication, and enforcement.¹¹⁹

117. *Id.* at 521.

118. If they were, this would raise the interesting philosophical and jurisprudential question of whether this activity is properly considered corrupt as opposed to an accepted, though ultimately destructive and inefficient, form of governance. *Cf.* JOHN T. NOONAN, JR., *BIBES: THE INTELLECTUAL HISTORY OF A MORAL IDEA*, at xiii–xiv (1984). *See generally* SUSAN ROSE-ACKERMAN, *CORRUPTION: A STUDY IN POLITICAL ECONOMY* (1978) (premising corruption on a cultural and moral distinction between public and private spheres). Noonan writes:

One society may be uncensorious of most reciprocities with its officeholders; there may be no legal response to them at all, and the appearance will be given of integrity everywhere. A different society may define bribes, legislate against bribetakers, and prosecute bribery in such a way as to suggest that the crime is ubiquitous.

NOONAN, *supra*, at xiii. He goes on to note that “What is a bribe depends on the cultural treatment of the constituent elements. The observer outside the culture, like the cynic or rigorist within it, is inclined to see the conventional differences as arbitrary and to reduce all reciprocities of a given kind to bribes” *Id.* at xiii. He therefore warns against “reductionism that eliminates conventions and looks only at function.” *Id.* at xiv. As understandable as this plea for cultural sensitivity is, corruption often does have grave functional consequences for societies in which it becomes deeply rooted and prevalent, as suggested by Douglas North’s diagnosis of an all-too-common suboptimal equilibrium of societies mired in extractive and predatory economic activity that inhibits development. *See* DOUGLAS NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE* (1990).

119. The literature on conceptual and measurement issues with respect to corruption, rule of law, and governance is large and rapidly growing in keeping with the increasing policy and academic interest in public governance. *See, e.g.*, CHRISTIANE ARNDT & CHARLES OMAN, *USES AND ABUSES OF GOVERNANCE INDICATORS* (2006); MICHAEL JOHNSTON, *SYNDROMES OF CORRUPTION: WEALTH, POWER AND DEMOCRACY* (2005); JOHANN GRAF LAMBSDORFF, *THE INSTITUTIONAL ECONOMICS OF CORRUPTION AND REFORM: THEORY, EVIDENCE AND POLICY* (2007); Nick Duncan, *The Non-Perception Based Measurement of Corruption: A Review of Issues and Methods from a Policy Perspective*, in *MEASURING CORRUPTION* 131 (Charles J.G. Sampford ed., 2006); Michael Johnston, *Measuring the New Corruption Rankings: Implications for Analysis and Reform*, in *POLITICAL CORRUPTION: CONCEPTS AND*

Perhaps this is the best we can do in grappling with the inevitable opacity of deliberately concealed social practices, but it yields a degree of uncertainty that is problematic in a variable so crucial to the quantitative analysis of law's effects and efficacy in the context of a developing country.¹²⁰

From the perspective of comparative institutional analysis, to which the study of law can contribute much, the problems in assessing the status of the rule of law, and levels of corruption and state institutional capacity are stark. The “new institutionalisms” that have had a powerful influence on the disciplines of economics, political science, and sociology made substantial strides in including informal norms, practices, and routines within their theoretical frameworks. However, when corruption, state incapacity, or public sector inefficiency so degrades governmental efficacy along with levels of trust within society and the polity, the value of using formal institutions—including those of law and regulation—as variables or indicators decays as well. The rule of law presumes a distinction between public and private, not only in theory but in practice. Yet corruption represents the blurring of that line as private interests use the state to appropriate rents. These conditions erode or destroy the formal characteristics of the rule of law, and thus call into question

CONTEXT 865 (Arnold J. Heidenheimer & Michael Johnston eds., 2001); Johann Graf Lambsdorff, *Measuring Corruption—The Validity and Precision of Subjective Indicators: (CPI)*, in MEASURING CORRUPTION, *supra*, at 81; Daniel Kaufmann, Aart Kraay & Massimo Mastruzzi, *Measuring Corruption: Myths and Realities*, DEV. OUTREACH, Sept. 2006, at 124, available at <http://www1.worldbank.org/publicsector/anticorrupt/corecourse2007/Myths.pdf>; Joel S. Hellman, Geraint Jones, Daniel Kaufmann & Mark A. Schankerman, *Measuring Governance, Corruption and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies*, (World Bank Pol’y Research Working Paper No. 2312, 2000); Daniel Kaufmann, Aart Kraay & Massimo Mastruzzi, *Governance Matters IV: Governance Indicators for 1996–2004*, (World Bank Pol’y Research Working Paper No. 3630, 2005); Daniel Kaufmann, Aart Kraay & Massimo Mastruzzi, *Governance Matters III: Governance Indicators for 1996–2002*, (World Bank Pol’y Research Working Paper No. 3106, 2003); Daniel Kaufmann, Aart Kraay & Pablo Zoido-Lobaton, *Aggregating Governance Indicators* (World Bank Pol’y Research Working Paper No. 2195, 1999); Dilyan Donchev & Gergely Ujhelyi, What Do Corruption Indices Measure? (Aug. 13, 2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1124066>). For empirical evaluations of rule of law reform programs and analyses of the conceptual and methodological issues involved, see BEYOND COMMON KNOWLEDGE: EMPIRICAL APPROACHES TO THE RULE OF LAW (Erik G. Jensen & Thomas C. Heller eds., 2003).

120. See Kevin E. Davis & Michael B. Kruse, *Taking the Measure of Law: The Case of the Doing Business Project*, 32 LAW & SOC. INQUIRY 1095 (2007) (critically analyzing the World Bank metrics of rule of law and quality of governance).

the validity and utility of legal variables in explaining patterns of economic behaviors and outcomes.

Likewise, the rule of law presumes that legal rules can be and are reasonably well-enforced, but enforcement is generally practically unavailable or ineffective where corruption is rife and where state institutional capacities have collapsed or remain undeveloped. Understanding political and economic practices and behavior under such conditions may require theoretical and methodological approaches that focus on the informal, rather than formal, attributes of social life, such as the prevalence of clientalism inside the state and out, the structure of patron-client networks, and the forms and extent of state capture. “Grand corruption”¹²¹ is often (if not typically) organized and therefore may be accurately described, at least in some cases, as institutionalized. Although this framing of corruption may carve out a continued and useful role for institutional analysis, it diminishes the import of law as a constraint on public and private behavior that is at the conceptual foundation of the legal origins theory.

The twin problems of corruption and enforcement provide a warning that developed and undeveloped countries often cannot be treated analytically in the same way. Their differences in institutional capacities and resources are simply too vast; their problems not only vary in degree and scale, but in kind.¹²² Those who believe law matters for political economic developments had best concern themselves with how to establish the rule of law in the first place—

121. “‘Grand’ corruption refers to malfeasance of considerable magnitude by people who exploit their positions to get rich (or become richer)—political or business leaders.” Eric M. Uslander, Dep’t Gov’t & Politics, Univ. Md.—College Park, *The Bulging Pocket and the Rule of Law: Corruption, Inequality, and Trust*, Conference Paper Presented at “The Quality of Government: What It Is, How to Get It, Why It Matters,” The Quality of Government Institute, Department of Political Science, Göteborg University, Göteborg, Sweden 53 (Nov. 17–19, 2005), available at <http://www.bsos.umd.edu/gvpt/uslaner/uslanerbulgingpocketgoteborg.pdf>.

122. For a comprehensive review of the empirical and theoretical literature on corruption, law, and development, see ERIC M. USLANDER, *CORRUPTION, INEQUALITY, AND THE RULE OF LAW: THE BULGING POCKET MAKES THE EASY LIFE* (2008). Uslander argues persuasively that corruption takes root in conditions of high inequality that favor the emergence of clientalism, and that its corrosive effect on institutional integrity and social trust perpetuates inequality and thus corruption. *Id.* at 23–75. Less developed countries therefore face dilemmas distinct from those of industrialized countries. *See id.* at 180–213. They are often caught in a trap of mutually reinforcing inequality, corruption, and poverty. If they could develop economically they might have the resources to redress inequality and escape corruption’s grip, but corruption hinders institutional and economic development. *Id.* at 246–48.

and this turns attention back towards politics and institutions. Stephan Haggard, Andrew MacIntyre, and Lydia Tiede state the political and institutional foundations of the rule of law succinctly:

[P]roperty rights and the integrity of contract are not simply the result of “getting the law right” in any narrow sense. Rather, property rights come out of a complex causal chain that includes a variety of complementary institutions and political bargains—with respect to security, appropriate checks on private capture of the state, institutional checks on state power, and the more discrete features of the judicial and legal system. In simplest form: Property rights and contracting rest upon institutions, but these in turn rest upon deep coalitions of consenting interests.¹²³

It follows that legal rules, let alone legal systems, cannot be imported or copied in some simple straightforward fashion.¹²⁴ A disturbing implication can be drawn from this acknowledgement of the importance of politics to the development and functioning of institutions, and institutions to the establishment and maintenance of the rule of law. Where the appropriately constitutive politics and/or institutions are lacking, the rule of law remains an abstraction. Consequently, the developing and undeveloped countries may be on fundamentally different developmental trajectories. The developed countries are able to draw on their greater state and legal capacities and parlay them into greater capacities for successful reform and adaptive change. If developing countries remain mired in corruption and underdevelopment, it is increasingly unlikely that this is because of their membership in a given legal family, if it ever was.

The seemingly intractable problems of many developing countries do not render comparative law irrelevant, but they do illustrate the need to integrate the comparative legal, historical, and political analysis in the study of economics and institutions. The perspectives of comparative political economy and comparative law are both essential to advance our understanding of governance and economic organization. This is just as true of the developing world where there is often a dearth of functional institutions and legal

123. Haggard et al., *supra* note 115, at 221. Haggard et al. provisionally simplify the rule of law to the “core” of property and contract rights for purposes of their discussion of its irreducibly political origins. *Id.* at 206–09, 221.

124. *Id.* at 221 (citing Frank Upham, *Mythmaking in the Rule-of-Law Orthodoxy, in* PROMOTING THE RULE OF LAW ABROAD 75 (Thomas Carrothers ed., 2006)).

development as it is of the advanced industrial countries with well-established institutional structures and legal systems. The legal origins literature initiated an exploration of important patterns of legal, institutional, and economic development. We are left with a puzzle. If legal families are not as determinative of economic outcomes as the LLSV path dependence account suggests, what are they measuring and what explains the variations across developed and undeveloped countries?

VIII. LEGAL ORIGIN AS POLITICAL PROXY?

Given the current state of our knowledge, this essay ends on a speculative note. The theoretical and empirical critiques of the legal origins theory have substantially undermined their claims. One possible answer to the question of what LLSV are measuring is that they are not measuring *anything* and that the conceptual, logical, and methodological flaws in the analyses lead to spurious correlations propping up specious conclusions. The critics of the legal origins theory have forced a reconsideration of whether specific legal rules can explain variations in financial development, but there do seem to be resilient patterns of variation with respect to the relation between legal families and more easily operationalized variables like dividends and financial market development. So it is likely that *something* is being measured and some real, and apparently systematic, variation has been detected. Without much more reliable data and much more detailed historical research, it is difficult and perhaps impossible to determine the cause of these variations.

If substantive law does not provide an answer, is it plausible that legal families are actually proxies for other political factors? This is fertile ground for further research on both colonial legacies and on the determinants of national corporate governance regimes and financial development, only the most general sketch of which can be presented here. A number of possible political economic characteristics may prove to have explanatory power. One might construct studies to examine the influence of state institutional structures; including parliamentary versus presidential systems, or majoritarian versus proportional representation electoral and party systems. Likewise, studies could analyze the complementarities and contradictions among institutions that constitute the political economy as a complex system. More difficult to measure are state capacities to exercise power and govern efficiently across different

policy domains. Finally, and perhaps most difficult to quantitatively measure are informal power relations among elites, the influence of informal norms in political and economic culture, corruption, and the relative development of the rule of law.

A number of studies in the colonial legacies literature cling to the common law-civil law distinction as the principal explanatory variable in accounting for differential development.¹²⁵ However, like the legal origins literature proper, these studies do not sufficiently address the potentially, perhaps likely, confounding effect of other political variables, such as those listed in the preceding paragraph, closely correlated with differences among colonial powers at different points in history. Once again, the common law-civil law distinction may be a proxy for other legacies of colonial rule and the studies do not adequately address this possibility.

Former colonies among the developing countries offer other political and historical characteristics for analysis as potential contributors to developmental outcomes after independence.¹²⁶ In these countries, the legal family initially was imposed, not as an accident of political birth, but as a mechanism of colonial rule that may have had any of a number of different objectives. These mechanisms ranging from brutal exploitation and resource extraction (as in the Belgian Congo) to the creation of self-sustaining and increasingly autonomous political and economic systems (as was the case in Britain's North American and Australian colonies). Yet, the character of political authority and the structure of its political and legal institutions, along with the primary purposes they served, varied not only across different colonial powers, but across a single colonizer's territories. The *manner* of colonial rule is a substantial determinant of its institutional and juridical legacies—not just the identity of a given colonizing power, its legal tradition, or even the

125. See, e.g., Sandra Fullerton Joireman, *Inherited Legal Systems and Effective Rule of Law: Africa and the Colonial Legacy*, 39 J. MOD. AFRICAN STUD. 571, 573–76 (2001); Darryl G. Waldron, *Latin America's Colonial Legacy: The Law and Its Relationship to Economic Development*, 48 THUNDERBIRD INT'L BUS. REV. 321, 339–42 (2006).

126. See, e.g., Grazilla Bertocchi & Fabio Canova, *Did Colonization Matter for Growth? An Empirical Exploration into the Historical Causes of Africa's Underdevelopment*, 46 EUR. ECON. REV. 1851 (2002); Gustav Hansson, *What Determines Rule of Law? An Empirical Investigation of Rival Models*, 62 KYKLOS 371 (2009) (review and econometric testing of competing theories of the determinants of the rule of law).

degree of its control over a territory.¹²⁷ Legal families may function as proxies of varying strength for the identity of the colonial ruler, the degree to which its political and legal institutions were replicated in the territory, or whether the colonial institutions were primarily extractive or devised to build up a self-sustaining local political and economic system.¹²⁸

IX. CONCLUSION

Notwithstanding the intensive criticism of the legal origins theory and its empirical findings, the legal origins theory has significantly influenced the study of finance, corporate governance, and their cross-national variation. Indeed, these criticisms reflect the

127. Cf. Daron Acemoglu, Simon Johnson & James Robinson, *The Colonial Origins of Comparative Development: An Empirical Investigation*, 91 AM. ECON. REV. 1369 (2001) (testing the hypothesis that extractive colonization produced enduring post-colonial legacies inimical to economic growth).

128. See generally JONATHAN TABOR KRIECKHAUS, DICTATING DEVELOPMENT: HOW EUROPE SHAPED THE GLOBAL PERIPHERY (2006); Michael Bernhard, Christopher Reenock & Timothy Nordstrom, *The Legacy of Western Overseas Colonialism on Democratic Survival*, 48 INT'L STUD. Q. 225 (2004) (arguing that the legacy of specific colonial powers continues to have an important effect on survival of democratic regimes); Robin Grier, *Colonial Legacies and Economic Growth*, 98 PUB. CHOICE, 317 (1999) (comparing effects of differing colonial policies in former British and French Colonies in Africa); Robin Grier, *The Effect of Religion on Economic Development: A Cross National Study of 63 Former Colonies*, 50 KYKLOS 47 (1997) (examining the theory that prevailing religious thought has affected economic growth in former British and Spanish colonies in Latin America); Hansson, *supra* note 126; Gregory N. Price, *Economic Growth in a Cross-section of Nonindustrial Countries: Does Colonial Heritage Matter for Africa?*, 7 REV. DEV. ECON. 478, 478-95 (2003) (suggesting that extractive colonial policies account for a portion of the growth gap between former colonies in Sub-Saharan Africa and other nonindustrial countries). These alternative theories of the origins of law and governance produce a proliferation of variables, in addition to legal families, that can be incorporated into empirical analysis, including (1) the identity of the colonial power (including religious heritage), (2) the degree to which the colony was settled by immigrants from the colonizing power (and the indigenous population killed or displaced), (3) the political and governance structures (*e.g.*, bureaucracies, courts, legislatures) and policies (*e.g.*, general and legal education, physical infrastructure, etc.) introduced during colonialization, (4) the exercise of direct or indirect rule, (5) the timing of initial colonization, (6) the duration of colonization, (7) the manner of achieving independence, and (8) the time elapsed since independence. Of course, data availability, comparability, and quality are a problem in grappling with these variables and may require the use of proxy variables. See Acemoglu et al., *supra* note 127, at 1370, 1374-75 (using high settler mortality as a proxy for the imposition of highly extractive forms of colonial organization and rule); Robert E. Hall & Charles I. Jones, *Why Do Some Countries Produce So Much More Output Per Worker Than Others?*, 114 Q.J. ECON. 83 (1999) (using latitude and the fraction of the population speaking a European language as proxies for the extent of Western European influence on colonial and post-colonial society and polity).

fact that they were among the first to attempt such wide-ranging studies of the relationship between law and finance, and because they were so successful in articulating, deepening, and expanding a well-defined research agenda that leveraged the intellectual appeal and policy influence of microeconomic theory and econometrics. This has had a salutary effect on comparative legal and economic research in that the legal origins literature has provided important evidence regarding cross-national variations in law and financial systems, and helped to shed light on the relationships between them. The revisions to LLSV's metrics and scoring may produce new findings that are illuminating, unexpected, and robust.

Even in its flaws, the legal origins literature has inspired scholars of comparative law, economics, and politics to look at corporate governance and financial systems in a broader frame of reference that, for all of its many challenges and limitations, is increasingly important in an era of international financial markets and legal reform. The contention that law matters was salutary at a time when private ordering captivated many in academic and policy circles. The import of law may be better made through more qualitative and historically grounded research, but well-designed and carefully executed quantitative studies can provide valuable, if partial, insights into broad patterns of legal, institutional, and economic organization and development. An extraordinary range of scholars who have followed their lead into related research areas owe LLSV a debt of gratitude for that even if they depart from the path of legal origins and leave the theory and its conclusions behind them.

On the other hand, legal origins theory have not been as successful in elucidating the development of law and legal institutions, or in enhancing our understanding of the operation of particular national corporate governance regimes. The quantitative analyses marshaled in its support have been crippled by theoretical and methodological limitations. It is strikingly ironic that LLSV's legal origins work, while premised on, and devoted to, empirically corroborating the proposition that law matters, should treat law in such a highly reductionist fashion. Indeed, LLSV have reduced law to such an extent that they find that legal family of origin matters in contexts where the rule of law itself is exceedingly weak. This suggests both a methodological problem of treating dissimilar cases alike in ways that tend to generate logically questionable or spurious findings, and deeper theoretical problems of excessive formalism and

functionalism, common to much economic theory and analysis. These deeper problems lose sight of the complexity of substantive and procedural law, and the institutional arrangements in which they are situated and that determine their effectiveness and practical import.

Large-*n* quantitative analysis is bedeviled by a trade-off: what is gained in range and scope useful to discern broad patterns in variation is lost in empirical detail and richness that permits us to understand how legal systems function as part of the broader political economy and the causal channels that drive the development of law and institutions over time. The abstract universality and ahistorical character of the functional categories and variables expand the theory's reach and generalizability of its findings, but become a weakness when the empirical analysis elides substantial changes in national legal and financial systems. Further, the highly deterministic and path dependent logic of the legal origins theory is in tension with global political and juridical trends towards substantial reform of corporate governance and securities market regulation during the past twenty-five years. The theory offers a comparative statics relationship between specific types of legal rules to increased financial development when recent history and current events call for a dynamic theory of institutional and juridical change.

The legal origins theory also tends to homogenize the country cases, failing to distinguish adequately among country cases with respect to differences in rule of law and institutional arrangements, while universalizing the normative implications and prescriptions derived from the studies. Developed and less developed countries cannot be subject to identical forms of analysis without distorting the findings. Colonial legacies and persistent power imbalances within the international system cannot be ignored or reduced to differences in legal origins. There is a notable bias in the framing of quality of law in the LLSV literature that favors pro-shareholder legal rules and higher levels of financial development. The theory tends to support the adoption of "high quality" legal rules regardless of local legal, institutional, or political conditions as a means of securing growth of equities markets and financial system development. After the collapse of the global financial system and the role of international markets in transmitting the crisis cross-nationally, this sanguine view of finance and markets is due for a searching reappraisal.

These limitations point to the potential value-added of institutionalist theories and more fine-grained qualitative and historically grounded empirical research to the study of the relationships among law, finance, and politics. Qualitative political and institutional analysis, along with traditional legal scholarship, takes seriously the political and juridical dimensions of financial systems and corporate governance regimes and can fill in the wide gaps—and correct the occasional distortions—left by economic theory and econometric analysis. By all means, the large-*n* analysis of these phenomena should be continued. Let a hundred scholarly flowers bloom, and do not mistake the vast size of the garden through intellectual blinders.