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Legal Origins and the Tasks of Corporate Law in Economic Development: A Preliminary Exploration

*John Ohnesorge**

I. INTRODUCTION

The Legal Origins approach, and the wealth of literature it has spawned, is surely good for something other than generating more literature (for which it clearly is very good). The approach has garnered a great deal of criticism,¹ but it has nonetheless raised very interesting issues about relationships between legal systems, business forms, and economic performance. It has also raised a challenge to traditional comparative law, a field that has been a bit staid and introverted.² In its favor, Legal Origins also takes methodology seriously, which is unfortunately too rare in traditional legal scholarship. The approach's attention to social science methodology suggests that it also aspires to advance the state of our knowledge about the world, but as other papers in the symposium point out in one way or another, there are problems with understanding the Legal Origins literature as a scientific breakthrough.³

Whether or not Legal Origins scholarship actually constitutes scientific progress, it may still be very important if it influences the real world of law, policy, and economic activity. As will be discussed in more detail below, developing countries do not select their economic policies and financial legal regimes in a vacuum, but rather are often pressured to adopt policies and legal institutions advocated

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1. See, e.g., Mark J. Roe & Jordan I. Siegel, *Finance and Politics: A Review Essay Based on Kenneth Dam's Analysis of Legal Traditions in The Law-Growth Nexus*, 47 J. ECON. LITERATURE 781 (2009) (summarizing existing criticisms and suggesting an alternative analytic approach).

2. John K.M. Ohnesorge, *China's Economic Transition and the New Legal Origins Literature*, 14 CHINA ECON. REV. 485 (2003).

3. See Holger, Spamann, and Simon Deakin in this issue.

by developed countries and international institutions. Given that one application of the Legal Origins theory is to advance economic and legal policy objectives for developing economies, the potential for Legal Origins to influence policy directives of these global institutions is substantial.

It is therefore important for those interested in law and development⁴ to pay attention to the fate of Legal Origins as a scholarly enterprise, and as an inspiration for policy. Corporations and other business entities are so obviously important to economic life that one might assume that comparative corporate law would long ago have been a point of interest for scholarship on law and economic development. Unfortunately, by and large this has not been the case. To date, the main focus of comparative corporate governance scholarship has been limited to comparisons between the United States, the United Kingdom, Western Europe, and Japan,⁵ while traditional law and economic development literature has had little focus on the law of business organizations. If Legal Origins scholarship is misguided, however, its ill effects will not be felt in the developed countries that are the main focus of comparative corporate law scholarship, because the corporate governance regimes of such countries tend to continue on their path-dependent ways unless domestic interests—not a group of foreign economists—align to shake them up.⁶ Rather, it will be developing and transition countries, influenced as they are by the policy prescriptions of aid agencies and international financial institutions, that could bear the costs.

This paper offers a preliminary roadmap for interrogating the Legal Origins school. Before focusing on Legal Origins, however, Part II will address a basic issue facing development efforts: the contractual and ideological restriction of policy choices available for the development of economic and legal systems. Part III then demonstrates how Legal Origins theory influences, and has the potential to further influence, the actual development of policy choices in international development. Given the actual and potential impact of Legal Origins theory on policy choice availability, Part IV

4. “Law and development” refers to efforts to assist legal system development in developing countries, as well as to scholarship analyzing and evaluating such efforts.

5. *See, e.g.*, REINIER R. KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 3 (2003).

6. CURTIS J. MILHAUPT & KATHARINA PISTOR, *LAW & CAPITALISM* 47–67 (2008).

then examines specific concerns raised by Legal Origins, and a common theme in this section will be how corporate law functioned in successful developing economies in Northeast Asia, as compared to the claims of Legal Origins and the development policy prescriptions that have followed. There may always be room for methodological debate with respect to how advocates of a general theory such as Legal Origins should deal with particular cases that do not seem to fit the general model, but for questions of economic development policy East Asia's exceptional development performance suggests that a general theory ought to be able to explain the East Asian experience.

II. LEGAL ORIGINS AND THE ISSUE OF POLICY SPACE FOR DEVELOPMENT

In the economic development literature one sees a great deal of concern over "shrinking policy space" for development: that is, in recent years developing countries have enjoyed less and less freedom to craft and implement their own measures to cope with the challenges of development.⁷ According to this view, developing countries have increasingly been under external pressure to adopt specific policy measures. Such pressure can come directly, through international legal obligations or the conditions imposed by international organizations, but it can also come indirectly, through the power of ideas and the professional training of policy experts. Those who oppose this trend commonly target the World Trade Organization (WTO)⁸ because the discipline imposed by the precursor General Agreements on Tariffs and Trade (GATT) regime left far more room for national governments to pursue individual development strategies.⁹ Although the WTO regime is responsible

7. See, e.g., Kevin P. Gallagher, *Globalization and the Nation-State: Reasserting Policy Autonomy for Development*, in *PUTTING DEVELOPMENT FIRST: THE IMPORTANCE OF POLICY SPACE IN THE WTO AND IFIS 1* (Kevin P. Gallagher ed., 2005); Robert H. Wade, *What Strategies Are Viable for Developing Countries Today? The World Trade Organization and the Shrinking of 'Development Space'*, 10 *REV. INT'L POL. ECON.* 621 (2003).

8. See, e.g., Alisa DiCaprio & Kevin P. Gallagher, *The WTO and the Shrinking of Development Space: How Big Is the Bite?*, 7 *J. WORLD INVESTMENT & TRADE* 781 (2006).

9. This was true for at least two reasons. First, the GATT disciplines applied primarily to the flow of goods across borders, and to issues such as government subsidies, or to dumping, which affected trade in goods. The WTO was designed to provide discipline over a far broader range of policy issues, ranging from the regulation of foreign direct investment (the TRIMS agreement), to trade in services (the GATS agreement), to the protection of

for some of the most obvious constraints on developing country policies, those constraints are treaty-based, contractual obligations, entered into by sovereign governments seeking the benefits of membership in the global trade regime. In that sense, the constraints of the WTO regime are similar to constraints imposed through conditionalities attached to aid received from the World Bank or the International Monetary Fund (IMF), two other oft-cited sources of policy space constraint. To their defenders, on the other hand, the World Bank and the IMF can be analogized to commercial lenders, with the reforms they demand from developing countries being the equivalent of protective terms or conditions demanded by the lender in exchange for a loan.

Second, policy space can also be constrained less contractually, through the training and belief systems of those who supply development assistance, especially when they correspond to the training and belief systems of those receiving that assistance. Orthodoxies develop in fields like development economics, and such orthodoxies shape the policies of the development assistance providers, as well as the policy imaginations of those in developing countries.¹⁰ Although influence of this type is harder to demonstrate than a WTO obligation or an IMF or World Bank conditionality, there is little doubt that changing ideas in development economics have affected both the activities of the development assistance providers, and the activities of developing country policy-makers.¹¹

Externally-imposed policy constraints might be explained as just a cost to be borne in order to enjoy some benefit, such as participation in the global trading regime. In that case the imposed policies need not be benefits in and of themselves to the constrained country to be justified; they just have to impose costs that are less

intellectual property (the TRIPS agreement). *See id.* at 785–93. A second important way in which the WTO tightens the disciplinary reins as compared with the GATT is through the judicialization of the dispute settlement system, and the fact that countries no longer have the legal right to block decisions that go against them. *Id.* at 794.

10. John K.M. Ohnesorge, *Developing Development Theories: Law and Development Orthodoxies and the Northeast Asian Experience*, 28 U. PA. J. INT'L ECON. L. 219, 221–22 (2006); Alice Amsden, *The Spectre of Anglo-Saxonization Is Haunting South Korea*, in KOREA POLITICAL ECONOMY: AN INSTITUTIONAL PERSPECTIVE 87 (L-J Cho & Kim YH eds., 1994) (describing the role of American-trained Korean economists in Korea's shift away from German and Japanese models of economic governance toward an Anglo-Saxon model).

11. *See* David M. Trubek & Alvaro Santos, *Introduction*, in THE NEW LAW AND ECONOMIC DEVELOPMENT I (David M. Trubek & Alvaro Santos eds., 2006).

than the more general benefits of participating in the regime. Such policy constraints are often not presented as simple costs, however; they are usually presented as benefits in and of themselves. The additional constraints imposed by the WTO over the GATT regime provided a good case in point of this treatment. Proponents of the constraints imposed by the TRIPS agreement on national intellectual property regimes defend them on the basis that improved intellectual property protection will benefit the target country by encouraging investment in research and development and innovation—in addition to benefitting other WTO members. The TRIMS agreement—constraining countries’ ability to impose restrictions on foreign direct investment—can be seen in the same way. In this sense, the constraints can be seen as helping the developing country do what was in its own interest, but which it could not accomplish for some reason such as the influence of domestic interest groups.

Whether policy constraints are presented as actually benefiting the constrained countries, or understood as costs that must be borne to achieve an offsetting good, such judgments should be based on evidence. By definition, constraints on policy choice are designed to take options off the table, to force a level of convergence in economic governance. But the idea of forcing convergence in governance tends to assume both a great deal of knowledge about the interaction of law and economic activity, and that the needs of all economies with respect to economic regulation are essentially the same. Knowledge about interactions between legal institutions and real economic activity would be necessary in order to decide which legal rules or institutions would produce the desired social end, even if the end itself were not in dispute. Economies at different stages of development, or pursuing different development strategies, have often pursued different ends with respect to economic governance, however,¹² so we should be attuned to the fact that seemingly technical convergence initiatives may have a homogenizing effect on development strategies.

The Legal Origins approach to comparative corporate law could potentially affect the policy space available to developing countries in both these ways, by informing the design of binding international obligations or of demands made by assistance providers, and also by

12. For a discussion of “varieties of capitalism” literature, see *infra* note 27 and accompanying text.

affecting the way policy makers understand and argue about the tasks of corporate law in developing economies. This paper therefore treats Legal Origins as informing both “contractual” and ideological constraints on the range of choices available to developing countries in the corporate law realm, and raises a set of concerns about that prospect. As will be discussed in Part IV below, these concerns are driven at least in part by the history of economic development in Northeast Asia, and the role of corporations and corporate law therein.¹³

III. LEGAL ORIGINS AND THE WORLD BANK’S DOING BUSINESS PROJECT

To understand the interaction between law and finance and law and development, it is crucial to focus on the Doing Business project of the World Bank.¹⁴ One might ask whether it makes sense to focus on the Doing Business project since it is only one unit within the World Bank involved in law reform work, and many of those working in the Bank hold diverse views on development issues.¹⁵ Nonetheless, there is no other unit within the Bank speaking so publicly and clearly on corporate law and economic development, so it seems fair to hold the Bank to the views expressed by the Doing Business group, even if there are alternative voices within the Bank.¹⁶ In addition, while institutions such as the International Monetary Fund, the European Union, and the United States government have also been involved in corporate law reform efforts, it seems that the Doing Business project offers the most important single statement by

13. See Ohnesorge, *supra* note 10, at 224 (arguing that to the extent that law and development orthodoxies “cannot accommodate the Northeast Asian experience . . . they are deeply inadequate”).

14. See generally The World Bank Group, Doing Business, <http://www.doingbusiness.org/> (last visited Jan. 14, 2010); The World Bank Independent Evaluation Group, Doing Business: An Independent Evaluation (2008) (reporting results of a review of Doing Business by the World Bank’s Independent Evaluation Group); Alvaro Santos, *Labor Flexibility, Legal Reform, and Economic Development*, 50 VA. J. INT’L L. 43 (2009) (discussing the Doing Business project and its effects on labor market policies in developing countries).

15. See TERRY HALLIDAY & BRUCE CARRUTHERS, BANKRUPT: GLOBAL LAWMAKING AND SYSTEMIC FINANCIAL CRISIS (2009) (voicing skepticism over the usefulness of studying the pronouncements of international financial institutions such as the World Bank).

16. In an otherwise fairly critical review, the World Bank’s Independent Evaluation Group describes Doing Business as “one of the Bank Group’s flagship knowledge products.” World Bank Independent Evaluation Group, *supra* note 14, at xiii.

any development institution on the relationship between corporate law and economic development. Before examining what Doing Business has to say about corporate law specifically, an overview of the project will help put the corporate law portions in context.

The general spirit of the Doing Business project draws heavily on the work of Hernando de Soto, who famously chronicled and criticized the formalities required to legally form and operate a business in Peru,¹⁷ combined with what has been described as the “league tables” approach to cross-national comparison.¹⁸ The Doing Business group gathers information from around the world in order to rank countries according to eleven different criteria, with most of the criteria designed to get at issues highlighted by de Soto, such as the steps required to register a legal business. The connection to Legal Origins comes through the investor protection portion within the larger project, which is tied very directly to the Law and Finance school.¹⁹

Stripped of its technical overlay, the Legal Origins message on corporate law and economic development, propagated via Doing Business, is straightforward. Private-led development is best, an assumption that has been dominant since more statist development approaches of the 1950s and 1960s were abandoned decades ago.²⁰ Private-led development depends upon financial markets to allocate capital, a rejection of the bank-centered financial systems chronicled in the “varieties of capitalism” literature,²¹ and a very clear rejection of the idea of allocating capital to industry through specialized development banks, as had been popular in the 1960s. Deep, liquid (“developed”) financial markets depend upon vigorous protections for minority shareholders, who provide capital but lack the voting power to protect their investments, and therefore the main focus of

17. HERNANDO DE SOTO, *THE OTHER PATH* (1989) (especially Chapter 5: The Costs and Importance of the Law). For an early critique of de Soto based on the Asian development experience, see Frank K. Upham, *Speculations on Legal Informality*, 28 *LAW & SOC’Y REV.* 233 (1994).

18. See WILLIAM TWINING, *GLOBALISATION AND LEGAL THEORY* 152–68 (2000) (discussing the creation of “league tables” for national legal systems as an example of mental mapping).

19. See generally World Bank Group, *Protecting Investors*, <http://www.doingbusiness.org/ExploreTopics/ProtectingInvestors/> (last visited Jan. 14, 2010).

20. See generally JAMES M. CYPHER & JAMES L. DIETZ, *THE PROCESS OF ECONOMIC DEVELOPMENT* 128–57 (2d ed. 2004) (discussing “developmentalist” approaches to economic development in the 1950s and 1960s).

21. See *infra* note 27.

corporate law reform for economic development should be the legal protection of shareholders' rights. Since controlling shareholders' interests are protected by majority voting provisions typically found in corporate law, the focus turns to legal protection for minority shareholders. Controlling shareholders actually tend to become the villains of the story, as it is their rapaciousness that the law must control, so minority shareholder rights come to the fore as the primary focus of corporate law reform.

Legal Origins began in academe, and while the world of scholarship clearly influences development assistance policies,²² such influence is usually too slow, indirect, and diffuse to easily trace—let alone to provoke a real political battle. Legal Origins may prove an exception to that general rule. As noted above, the most apparent conduit through which Legal Origins scholarship exerts influence in the world of development assistance is through the World Bank's Doing Business project, which ranks countries according to many criteria, including “investor protection,”²³ an indicator that draws directly from Legal Origins scholarship. While this may seem like an unimportant use of already arcane scholarship, the Doing Business project's championing of labor market flexibility over workers' rights in its “Employing Workers” index,²⁴ as well as its stance on specific tax issues, led the U.S. Congress to target Doing Business in an appropriations bill provision somewhat bluntly entitled “Reform of the ‘Doing Business’ Report of the World Bank.”²⁵ World Bank

22. Trubek & Santos, *supra* note 11.

23. Doing Business, World Bank Group, Protecting Investors, <http://www.doingbusiness.org/ExploreTopics/ProtectingInvestors/> (last visited Jan. 14, 2010).

24. See Santos, *supra* note 14, at 64.

25. The full text of § 1626(a) reads:

Sec. 1626. Reform of the ‘Doing Business’ Report of the World Bank

(a) The Secretary of the Treasury shall instruct the United States Executive Directors at the International Bank for Reconstruction and Development, the International Development Association, and the International Finance Corporation of the following United States policy goals, and to use the voice and vote of the United States to actively promote and work to achieve these goals:

(1) Suspension of the use of the ‘Employing Workers’ Indicator for the purpose of ranking or scoring country performance in the annual Doing Business Report of the World Bank until a set of indicators can be devised that fairly represent the value of internationally recognized workers' rights, including core labor standards, in creating a stable and favorable environment for attracting private investment. The indicators shall bring to bear the experiences of the member governments in dealing with the economic, social

leadership claims to have responded by notifying staff that “the [Employing Workers Indicator] does not represent World Bank policy and should not be used as a basis for policy advice or in any country program documents that outline or evaluate the development strategy or assistance program for a recipient country.”²⁶ The Legal Origins-inspired “investor protection” indicator was not targeted in the same way, but the episode demonstrates that the real world can take notice when scholarship becomes tied directly to controversial policy reform agendas, as is arguably the case with Legal Origins and the Doing Business project.

IV. OBSERVATIONS AND CONCERNS

Having outlined the importance of the Legal Origins approach for those interested in law and economic development, the following sections raise a set of concerns about the use of Legal Origins to inform corporate law reform for developing countries. As noted above, most of these concerns are driven in one way or another by the history of economic development in East Asia. One set of concerns relates to methodology, and the way in which hypotheses are formed and tested. Other concerns relate to effects Legal Origins

and political complexity of labor market issues. The indicators should be developed through collaborative discussions with and between the World Bank, the International Finance Corporation, the International Labor Organization, private companies, and labor unions.

(2) Elimination of the ‘Labor Tax and Social Contributions’ Subindicator from the annual Doing Business Report of the World Bank.

(3) Removal of the ‘Employing Workers’ Indicator as a ‘guidepost’ for calculating the annual Country Policy and Institutional Assessment score for each recipient country.

Supplemental Appropriations Act of 2009, Pub. L. No. 111–32, § 1110, 123 Stat. 1902 (amending 22 U.S.C. § 262p). The attempt by Congress to reign in the Doing Business Group received some publicity, but it appears that this was primarily because President Obama used a signing statement to signal that he saw this as Congressional interference in his conduct of foreign affairs. Charlie Savage, *Obama’s Embrace of a Bush Tactic Riles Congress*, N.Y. TIMES, Aug. 9, 2009, at A16, available at <http://www.nytimes.com/2009/08/09/us/politics/09signing.html>. To access President Obama’s signing statement online, see Press Release, White House Office of the Press Sec’y, Statement from the President upon Signing H.R. 2346 (June 24, 2009), available at http://www.whitehouse.gov/the_press_office/Statement-from-the-President-upon-signing-HR-2346/.

26. Press Release, Bank Info. Ctr., Frank Praises Changes to World Bank “Doing Business” Report (Apr. 28, 2009), available at <http://www.bicusa.org/en/Article.11123.aspx>.

may have on basic understandings of law, capitalism, and entrepreneurial spirit.

A. Methodology

One concern is a basic methodological point about how theory is generated. An initial hypothesis ought to be tested against data. If the data does not confirm the hypothesis, then the hypothesis ought to be refined or discarded. There is plenty of literature criticizing Legal Origins in terms of data and methodology, but my concern is more with the way in which the initial hypotheses were developed. It appears that the hypotheses may have been developed in a mood of “irrational exuberance” over Anglo-American economic ascendance, and by people committed to a particularly free-market vision of capitalism. There is nothing surprising about this blending of scholarship with political preferences, as this kind of scholarship is inherently political in a way that real science is not. The issue, though, is that when forming hypotheses about law and successful corporate development, there is no justification for not considering a range of successful episodes of capitalist development when formulating the hypotheses. There is an enormous literature on varieties of capitalism, and this literature has long explored questions that would seem central to Legal Origins, such as the role of the state in economic governance.²⁷ It would seem that this literature would be a natural source of insights, but it seems largely absent from the bibliographies of the Legal Origins school.²⁸ Engaging more with this existing literature could have highlighted a set of issues that are implicated by the choice of corporate law rules and institutions, and would also have highlighted the fact that successful market economy legal systems differ along these issues.

For example, it has long been noted that economies differ with respect to the “patience” of capital. Japan and Germany are often

27. See, e.g., PETER GOUREVITCH, POLITICS IN HARD TIMES: COMPARATIVE RESPONSES TO INTERNATIONAL ECONOMIC CRISES (1986); NATIONAL DIVERSITY AND GLOBAL CAPITALISM (Suzanne Berger & Ronald Dore eds., 1996); THE END OF DIVERSITY? PROSPECTS FOR GERMAN AND JAPANESE CAPITALISM (Kozo Yamamura & Wolfgang Streeck eds., 2003); THE ORIGINS OF NONLIBERAL CAPITALISM: GERMANY AND JAPAN IN COMPARISON (Wolfgang Streeck & Kozo Yamamura eds., 2001); VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE (Peter A. Hall & David Soskice eds., 2001).

28. See MILHAUPT & PISTOR, *supra* note 6.

noted for long-term, stable relationships between investors and management, while the United States in particular has been cited as an economy in which investors are much more concerned with short-term returns.²⁹ In the 1980s, when Americans were searching for explanations for the ascendance of Japanese industry, the “patience” of Japanese investors was cited as an advantage because it allowed Japan’s corporate managers to adopt longer time horizons than their U.S. competitors, who had to focus more intently on stock prices and footloose investors.³⁰ Whether or not this comparison was accurate in the 1980s, it highlights an important issue for corporate law design: the trade-off between encouraging management to focus on investors and giving management the freedom to adopt long-term strategies and to take risks. If we envision this trade-off as a spectrum, Legal Origins seems strongly biased toward what could be called the Anglo-Saxon view, in which management is supposed to focus on returns to shareholders and is biased against greater management autonomy. This view goes hand in hand with the preference for market-centered over bank-centered finance, and is reflected in the method’s obsession with minority shareholder protection. This makes sense if the central problem for corporate law to address is managerial opportunism and the agency slack that can exist between shareholders and management, or controlling shareholders.

If the Legal Origins scholars had started their inquiry into corporate law and economic performance more empirically and inductively, by looking at successful economic development episodes and then asking what kind of corporate law had been in place, they would almost certainly have looked at countries in Northeast Asia. These countries provide the best modern examples of long-term economic growth where private corporations played a central role. Even cursory attention to Northeast Asia would have revealed highly successful corporate-led growth in civil law countries, a serious challenge to prescriptive uses of Legal Origins, though to add to the complexity it is fairly clear that local economic, social, and political

29. See Sigurt Vitols, *From Banks to Markets: The Political Economy of Liberalization of the German and Japanese Financial Systems*, in *THE END OF DIVERSITY? PROSPECTS FOR GERMAN AND JAPANESE CAPITALISM*, *supra* note 27, at 240.

30. See, e.g., Wolfgang Streeck & Kozo Yamamura, *Introduction: Convergence or Diversity? Stability and Change in German and Japanese Capitalism*, in *THE END OF DIVERSITY? PROSPECTS FOR GERMAN AND JAPANESE CAPITALISM*, *supra* note 27, at 1–2.

conditions greatly influenced the way imported civil law forms actually functioned in Northeast Asia. Looking at successful corporations in Taiwan and Korea would have revealed founding, controlling shareholders firmly in charge in the vast majority of successful corporations, though using different methods to construct corporate groups.³¹ Minority shareholder rights were weakly protected in law, but small investors who bought the floated shares in such corporations surely did not expect to be able to use the law to enforce their rights, and were instead playing the market in ways that did not matter much to the controlling shareholders because corporations had other sources of capital. Japan's corporate organization was quite different during its high-growth decades, with little family control of major corporations. Instead, banks and insurance companies provided the relatively stable, large shareholding that allowed management freedom to engage in long-term planning and investment, and to take risks that they might not have taken if they were worried about lawsuits by minority shareholders.³²

B. Worse than Just Mistaken?

A second concern with Legal Origins is that this approach over-emphasizes corporate law at the expense of other variables that could be much more important for economic activity, especially to developing countries.³³ In doing so, Legal Origins thinking may be more than just mistaken, but actually harmful and misleading. It would seem that for a developing country with few successful corporations, the major tasks of corporate law would be to encourage entrepreneurs to invest their own capital in productive

31. The classic *chaebol* form in Korea involves founding family control of corporate groups through interlocked shareholding of related companies. See Myeong-Hyeon Cho, *Reform of Corporate Governance*, in *ECONOMIC CRISIS AND CORPORATE RESTRUCTURING IN KOREA* 286, 286 (Stephan Haggard, Wonhyuk Lim & Euysung Kim eds., 2003). The classic depiction of Taiwan's private business groups focused on family ties, rather than cross-shareholding, to hold groups together. See Susan Greenhalgh, *Families and Networks in Taiwan's Economic Development*, in *CONTENDING APPROACHES TO THE POLITICAL ECONOMY OF TAIWAN* 224, 224 (Edwin A. Winckler and Susan Greenhalgh eds., 1988).

32. MILHAUPT & PISTOR, *supra* note 6, at 90-91.

33. One explanatory variable that common sense would suggest might be more important than corporate law or some other institutional factor would be a government's actual policy choices. On this point, see Peter Blair Henry & Conrad Miller, *Institutions vs. Policies: A Tale of Two Islands* (Nat'l Bureau of Econ. Res., Working Paper No. 14604, 2008), available at <http://www.nber.org/papers/w14604>.

enterprises, to help them attract early-stage capital from outside investors as necessary, and to give them the incentives and the flexibility that would allow them to take the large risks that they will face as they try to capture markets and to grow. This is particularly true when the goal is export-led growth, in which products must compete on international markets, the competition will be fierce, and risk-taking and flexibility will be at a premium. None of these tasks is closely related to the strength of minority shareholder protections in corporate law, the central concern of Legal Origins.³⁴ Limited liability is probably crucial, but early private equity investors, like creditors, can protect themselves through contract rather than statutory corporate law protections. As for the incentive structure and the flexibility necessary to build a substantial corporation, both of these may well be in conflict with highly developed legal protections for minority shareholders. If the South Korean corporate law of the 1960s and 1970s was subjected to a law-in-action application of the Director Liability Index, the Shareholder Suits Index, and the other indices that make up the Investor Protection Index, it would have failed miserably. But whatever corporate law did do in rapidly developing Korea was obviously sufficient to facilitate entrepreneurship, capital accumulation, and risk-taking, which was clearly sufficient for high-speed development. What corporate law did not do very effectively was constrain majority shareholders for the protection of minority shareholders, but that seems like a secondary or intermediate task of corporate law in developing countries, not the primary task, unless one assumes that external equity finance is crucial, which the historical success of bank-centered financial systems in Germany, Japan, and elsewhere has shown is not correct.³⁵

A related concern is that the Legal Origins tradition focuses on the intermediary condition, the legal system, and corporate law, rather than on the actual substantive goal which law should serve. This is common in attempts to achieve particular societal results via general institutional reforms, but it is nevertheless problematic. Even if left unstated, ultimate social goals are often encoded into the approach that is chosen. For example, a decision to focus on minority shareholder protection is based on a view about what kind

34. See Ohnesorge, *Developing Development Theories*, *supra* note 10, at 252.

35. See “varieties of capitalism” discussion *supra* Part IV.A.

of corporation is the ultimate end, while the ultimate end may not be subject to the debate that it deserves. In the Legal Origins tradition the intermediate objective for corporate law seems to be developed equity markets as a source of external finance, while the link between external finance and successful corporations receives much less attention. The assumption is that finance through the equity markets will be important for developing a successful corporate sector, but data from a country like South Korea during rapid development would call that into question. The traditional account is that the Korean *chaebol* were financed primarily by bank lending and by retained earnings, rather than through the equity markets, and the government played a role in guiding the allocation of capital from the banks.³⁶ It is undisputed that this system worked well enough for world-class corporations such as Samsung, Hyundai, and LG to develop essentially from nothing.

The Korean government's rationing of credit during the decades of rapid growth raises the issue of government failure, as it should. It reflected older approaches to development economics that saw market failure everywhere in developing economies, and did not worry too much about the prospect of government failure.³⁷ In its focus on equity markets as the source of capital, Legal Origins may have moved too far in the opposite direction, focusing too heavily on market solutions to the challenges of development. It is theoretically possible that if the proper framework of corporate law is put in place, corporate development will take care of itself, avoiding the risk of government failure, but modern history is not filled with examples of this. Rather, Legal Origins tends to make necessity out of virtue, which may create very misleading ideas about how law and capitalism interact in the real world. Abuse of dispersed shareholders by unaccountable management in a Berle-Means corporation³⁸ is bad, just as abuse of minority shareholders by unaccountable *chaebol* chairmen is bad. Effective legal protections for small shareholders are

36. JUNG-EN WOO, RACE TO THE SWIFT: STATE AND FINANCE IN KOREAN INDUSTRIALIZATION (1991).

37. See generally JAMES M. CYPHER & JAMES L. DIETZ, THE PROCESS OF ECONOMIC DEVELOPMENT 128-57 (2d ed. 2004) (discussing "developmentalist" approaches to economic development in the 1950s and 1960s).

38. "Berle-Means corporation" refers to a publicly traded corporation, the governance of which is characterized by a separation of ownership from control due to the inability of dispersed shareholders to effectively control management. See ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 78-84 (1991).

good, as are efficient, well-functioning financial markets. The danger to clear analysis is to confuse what is good with what is necessary, and this is one of the real shortcomings of Legal Origins.

A final concern is that the Legal Origins approach contributes to a basic misunderstanding of entrepreneurship, and the drive to create businesses, that is the real driving force behind private-led economic development. In describing American law in the nineteenth century, the great legal historian Willard Hurst spoke of the law's role in the "release of energy" that was necessary to settle the country and develop the private economy.³⁹ In Hurst's words, "The substance of what business wanted from law was the provision for ordinary use of an organization through which entrepreneurs could better mobilize and release economic energy."⁴⁰ Entrepreneurs wanted from the law an "orderly capital subscription procedure under which capital could be fed into the enterprise," they wanted limited liability, and they wanted "a form of organization which firmly and broadly delegated power over mobilized capital to managers and directors."⁴¹ "[C]apital mobilization and discipline were the heart of the matter."⁴² Hurst was describing the role of corporate law when America was a developing economy, but it is not a bad description of the way corporate law functioned in rapidly developing Northeast Asia. By contrast, Legal Origins tends to vilify the entrepreneur, such as the *chaebol* chairman, who creates and leads the corporation, but without that entrepreneur, there is no business. History, in America as well as Northeast Asia, suggests that successful capitalist development must leave plenty of room for the play of what Keynes called the "animal spirits." Keynes wrote that "[m]ost, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits—of a spontaneous urge to action rather than inaction"⁴³ Corporate law in developing countries must play some role in protecting investors from the "animal spirits" of founders and controlling shareholders. To that end Legal Origins

39. JAMES WILLARD HURST, *LAW AND THE CONDITIONS OF FREEDOM IN THE NINETEENTH-CENTURY UNITED STATES* 1–32 (1956).

40. *Id.* at 17.

41. *Id.*

42. *Id.*

43. JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY* 161 (1936).

can be helpful. But, at the same time, it must encourage the release of entrepreneurial energy without which there will be no growing, successful corporations in which minority shareholders can invest.

V. CONCLUSION

The Legal Origins school has raised many interesting questions about the role of corporate law in economies around the world, and has attempted to provide a rigorous methodology for exploring those questions. For that it must be praised, as comparative scholarship on law and economic development has not been noted for rigorous methodology. On the other hand, given that the real-world influence of Legal Origins at the World Bank and elsewhere appears to have outstripped the approach's intellectual foundations, it is important to raise serious questions about its methodology, its assumptions, and its effects. This paper offers a preliminary roadmap for interrogating the Legal Origins school, looking in part at how corporate law functioned in successful developing economies in Northeast Asia, and matching that against the Legal Origins prescriptions. If they do not match up, something ought to give, and it really should be the theory.