
Calibrating and Comparing Regulatory Regimes

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'Legal Origin: Principal claims (1)



1. 'Quality of law' or 'law matters'

Economic development is linked to the quality of legal institutions in (inter alia) investor protection and labour regulation

Theory : basic agency model of corporate governance (see Shleifer and Vishny, 1996)

Empirical evidence:

La Porta *et al* (1997, 1998) (shareholder and creditor protection)

La Porta *et al* (2005) (self-dealing); Djankov *et al* (2006) (bankruptcy)

La Porta *et al* (2003) (securities regulation)

Botero *et al* (2004) (labour laws)

Objections

1. Causality: Coffee (2001), Cheffins (2001): which came first, law or investors?
2. Doesn't politics explain law? Roe (1999, 2003)

'Legal Origin: Principal claims (2)



2. 'Legal origins'

The quality of legal institutions varies systematically with the 'origin' of a country's legal system (English common law vs French, German, Nordic civil law).

Empirical evidence:

La Porta *et al* (1997) and all papers thereafter...

A response to objections? Legal origins are 'exogenous' – determined long before development of modern stock markets or labour markets – implies that law (legal origin) is the causal factor.

Theory? see Ross and Levine (2004, 2005)

- (i) 'Adaptability channel': common law jurisprudence as a form of Hayekian 'spontaneous order' vs. civilian 'top-down' regulation
- (ii) 'Political channel': common law judiciary more independent and better able to defend private property against 'rent-seeking' governments

- The description of the difference between the civil law and common law systems given in the new comparative economics is a caricature: ‘a superficial and outdated image of the differences between the common law and the civil law’ (Mattei)
- Legislation is highly significant as a source of norms for the common law systems in the area of economic regulation
- And the judges have been a source of some of the most significant innovations in the civil law world
- Civil law judges arguably have greater power to control outcomes than their common law counterparts, through the use of general clauses

‘Institutional channel’



- Differences in common law and civil law approaches can be traced to (1) the original conditions of industrialisation in parent systems and (2) the subsequent diffusion of norms, not just through colonisation but also transnational standards, regulatory competition and copying of dominant models (e.g. ILO conventions on dismissal law in 1960s; corporate governance codes today)
- ‘Weak’ legal origin effect derives from role of common law and civil law legal cultures as ‘carriers of history’; but politics, harmonisation and transplantation may be more powerful forces today
- No assumption that common law will produce more efficient rules
- Need to focus on conditions of reception of laws in transplant systems

Empirical methodology: Quantitative comparative law?



- Application of quantitative methodology to law
- ‘Indices’ of legal rules are constructed:
 1. Theoretical specification of functional types of rules which may be expected to have an impact upon economic variables
 2. Selection of particular rules as proxies for this rule-type: the ‘index variables’
 3. Numerical values attributed to (non) existence of legal rules in relation to the ‘index variables’; normalised to a value between 0 and 1.
 4. Scores for individual variables aggregated for each country to generate index of legal rules.

La Porta *et al* (1998) Antidirector rights

- Proxy by mail allowed?
- Shares not blocked before general meeting
- Cumulative voting
- Oppressed minorities mechanism
- Right to demand general meeting
- Pre-emption rights

Does not distinguish between (i) shr-manager agency problem and (ii) shr-shr agency problem

La Porta *et al* (1998): 'Creditor rights'

1. No debtor in possession?
2. No automatic stay in reorganisation?
3. Secured creditors get paid first?
4. Restrictions on going into reorganisation?

These miss

- (i) protection of creditors in company law;
- (ii) protection of creditors by contract/ security (see Haselman, Pistor & Vig, 2006)

Also likely wrongly specified (e.g. 2 is probably contrary to creditors' interests) (see Claessens and Klapper 2005)

- Botero *et al.* (2004) The Regulation of Labour
 1. Common law systems regulation the employment relationship less intensively than civil law ones (employment protection index); industrial relations systems also differentiated by legal origin
 2. Greater intensification of labour regulation associated with inefficiencies (high youth unemployment, low male unemployment rate)

Problems: tendency to over-use binary variables; unclear how default rules and self-regulation are dealt with.

But: seems to correlate well with opinion on perceptions of rigidity/flexibility of labour law.

(1) 'Quality of law'

- Selection bias: The variables included in the index give a very limited view (e.g. Armour, Cheffins & Skeel, 2002; Siems, 2005)
- Aggregation: The weighting of values for different clusters of variables is done in an arbitrary way (e.g. Ahlring and Deakin, 2005)
- Coding error: The wrong values have been attached to the variables (e.g. Spamann, 2006)

(2) 'Legal Origins'

- Arbitrary coding: civil/common law distinction is overly reductive and not a meaningful way of classifying legal systems (e.g. Siems, 2006)
- The underlying mechanisms are not well-specified
- Why are there are such strong path dependencies?

Our research: 'comparative dynamics' of legal systems



- 1. Theory : Analysing the theoretical foundations of the law-economy relation (examining the 'political' and 'adaptability' channels, and exploring the idea of 'legal culture').
- 2. Qualitative empirical research: Carrying out qualitative research, based on case studies, historical evidence, and interviews, on the processes and impact of legal change in a number of countries
- 3. Quantitative analysis: Producing new indices for shareholder protection, creditor rights and labour regulation which are longitudinal, thereby opening up the possibility of time-series analyses
 - Do the *dynamics* of different legal systems operate differently?
 - (How) do the strength of path dependencies vary?
 - Can La Porta *et al's* results be replicated with a more defensible index?
 - Does legal change lead to financial development or *vice versa*?

(3) Quantitative evidence



- Panel data on legal variables constructed
- New indices used, with careful specification

	Shareholder rights	Creditor rights	Labour rights
Stage 1: 5 countries, 60+ variables, 1970-2005	Completed Feb 2006 (Lele and Siems, 2007)	Completed Nov 2006 (Armour, Lele, Siems)	Completed June 2007 (Deakin, Lele, Siems)
Stage 2: 20 countries, 10 variables, 1995-2005	Completed Oct 2006 (Siems, 2007)	In progress	In progress

1. Jurisdiction selection (Stage 1)
 - ‘Mother countries’ + US (largest economy) + India (large developing nation)
 - 2 ‘civil law’, 3 ‘common law’

2. Rule selection: functionality
 - Scope of areas considered (‘shareholder rights’ (listed companies); ‘creditor rights’, ‘labour regulation’)
 - Sources of law (/‘law’) considered (case law, soft law, Delaware)
 - Mandatory/default rules (e.g. UK’s ‘Table A’)

3. Rule coding: transparency
 - Goal: coding performed or verified by lawyers trained in relevant jurisdictions
 - Judgements must be made ... detailed ‘workings’ kept

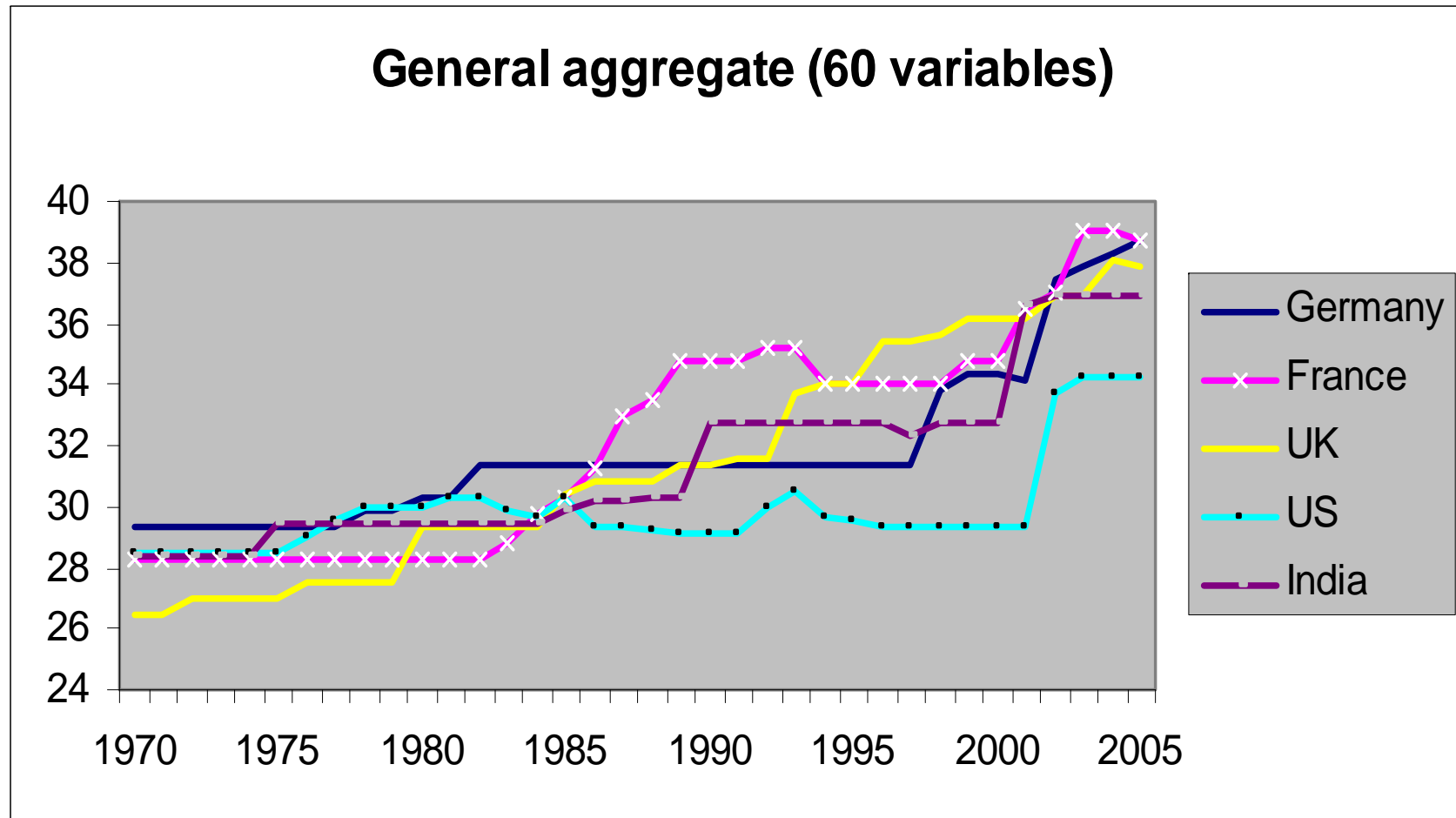
4. Aggregation
 - All variables weighted equally: need to be aware of limitations

Shareholder protection

1. Shareholders vs Directors
2. Shareholders vs Shareholders

Shareholder protection

General trends 1970-2005, 5 countries



N.B. What can this tell us?

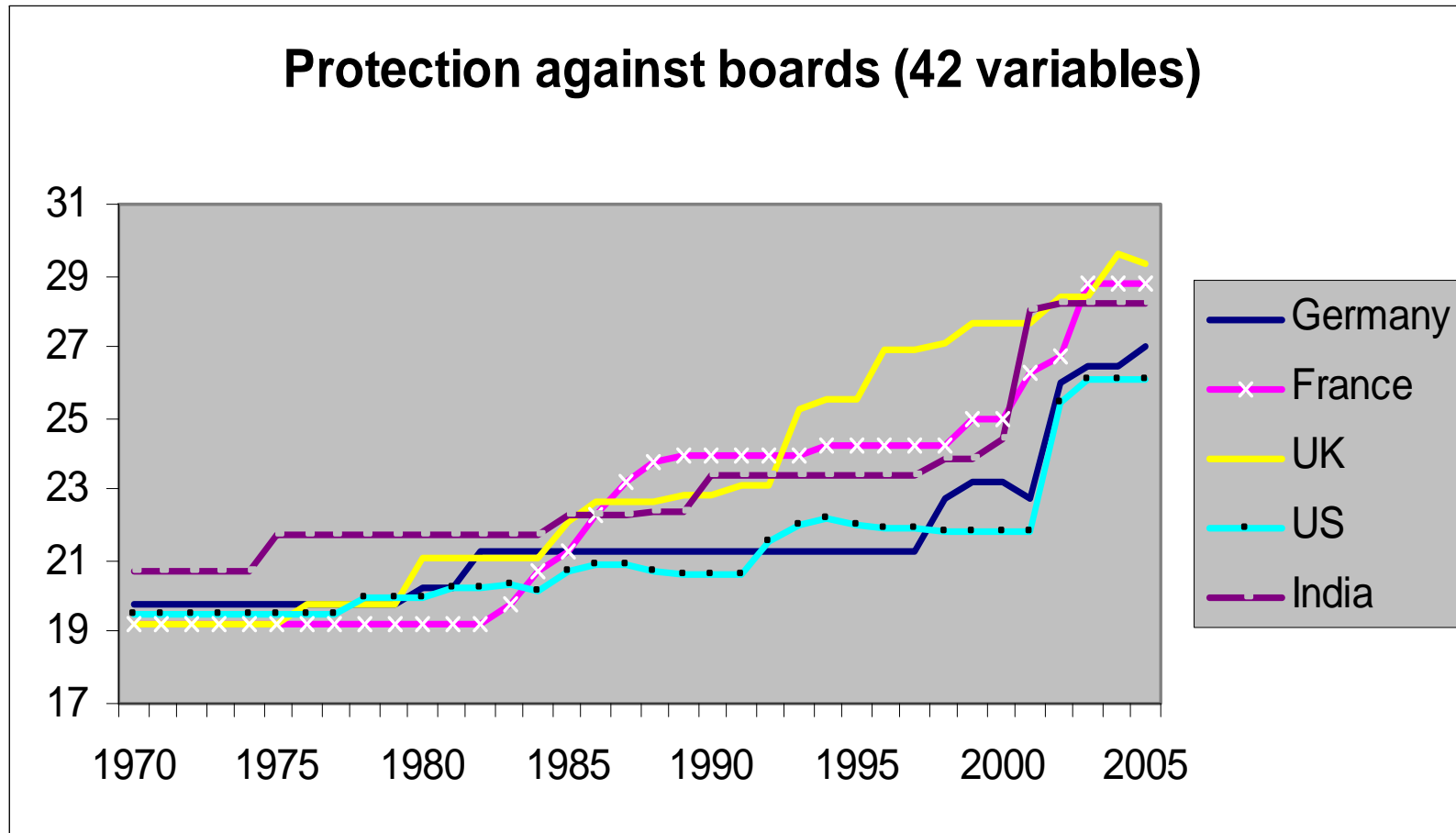
- It can tell us
 - About ‘direction’ of legal change
 - About pace of legal change (incremental or punctuated)
 - About whether civil / common law behave differently

- It cannot tell us
 - About how the ‘law in action’ operates
 - About how the law affects the economy (cf. future work)
 - About which system is ‘better’

Shareholder protection index: (i) Protection vs board (42 variables)

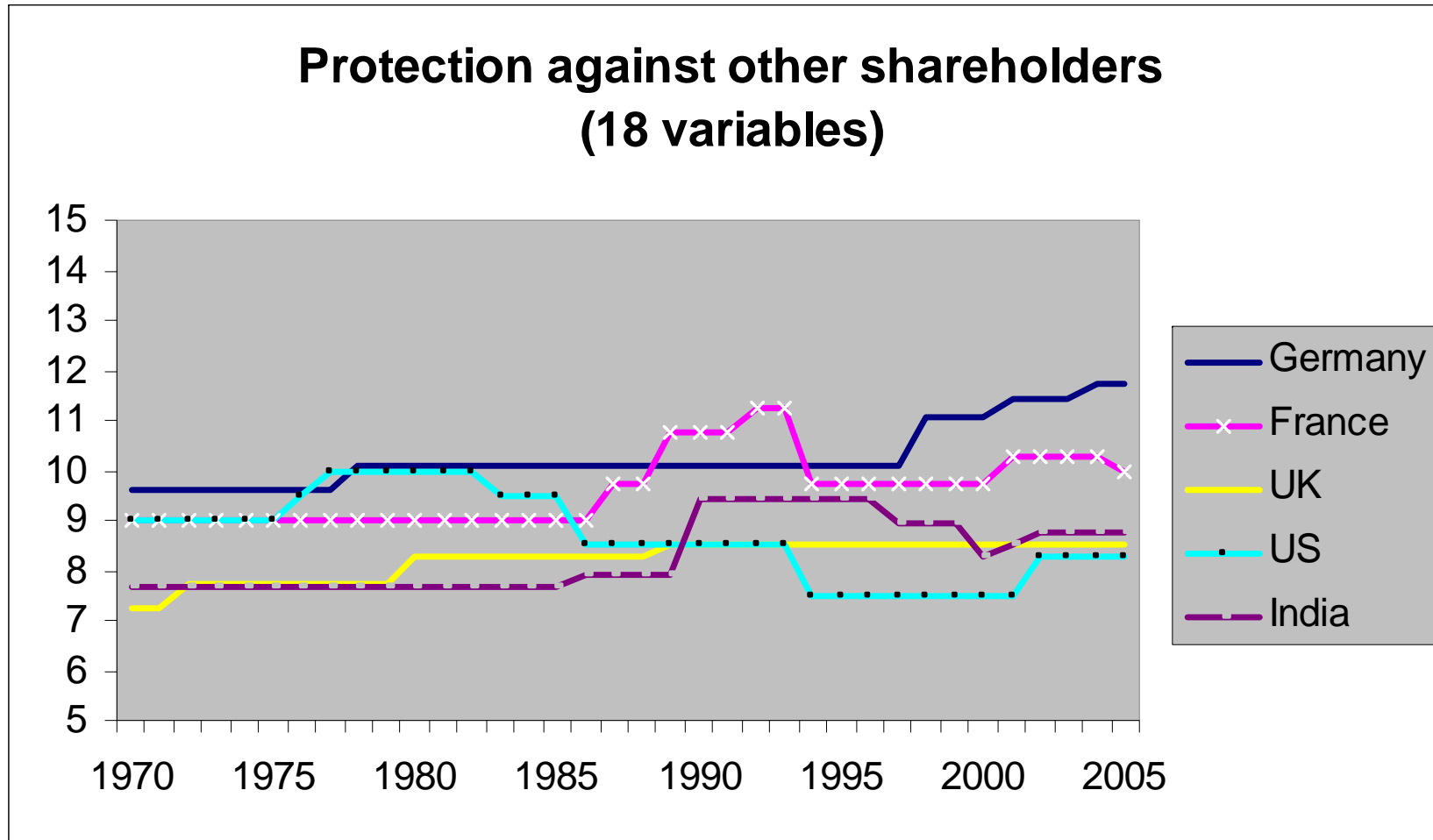


1. Jurisdiction of general meeting (7)
2. Shareholder agenda-setting power (in general meeting) (3)
3. Power to requisition general meeting (2)
4. Facilitation of proxy appointments (3)
5. Information available prior to general meeting (2)
6. Shares not blocked before general meeting (1)
7. Shareholder rights to demand information (2)
8. Communication with other sh'rs (2)
9. Board composition (3)
10. Controls on directors' remuneration (3)
11. Performance-based pay for directors (1)
12. Term limits for directors' tenure (2)
13. Directors' duties (3)
14. 'Shareholder primacy' (2)
15. Pre-emptive rights (1)
16. Director disqualification regime (1)
17. Corporate governance code (1)
18. Public enforcement of company law (3)



(ii) Protection against majority shareholder

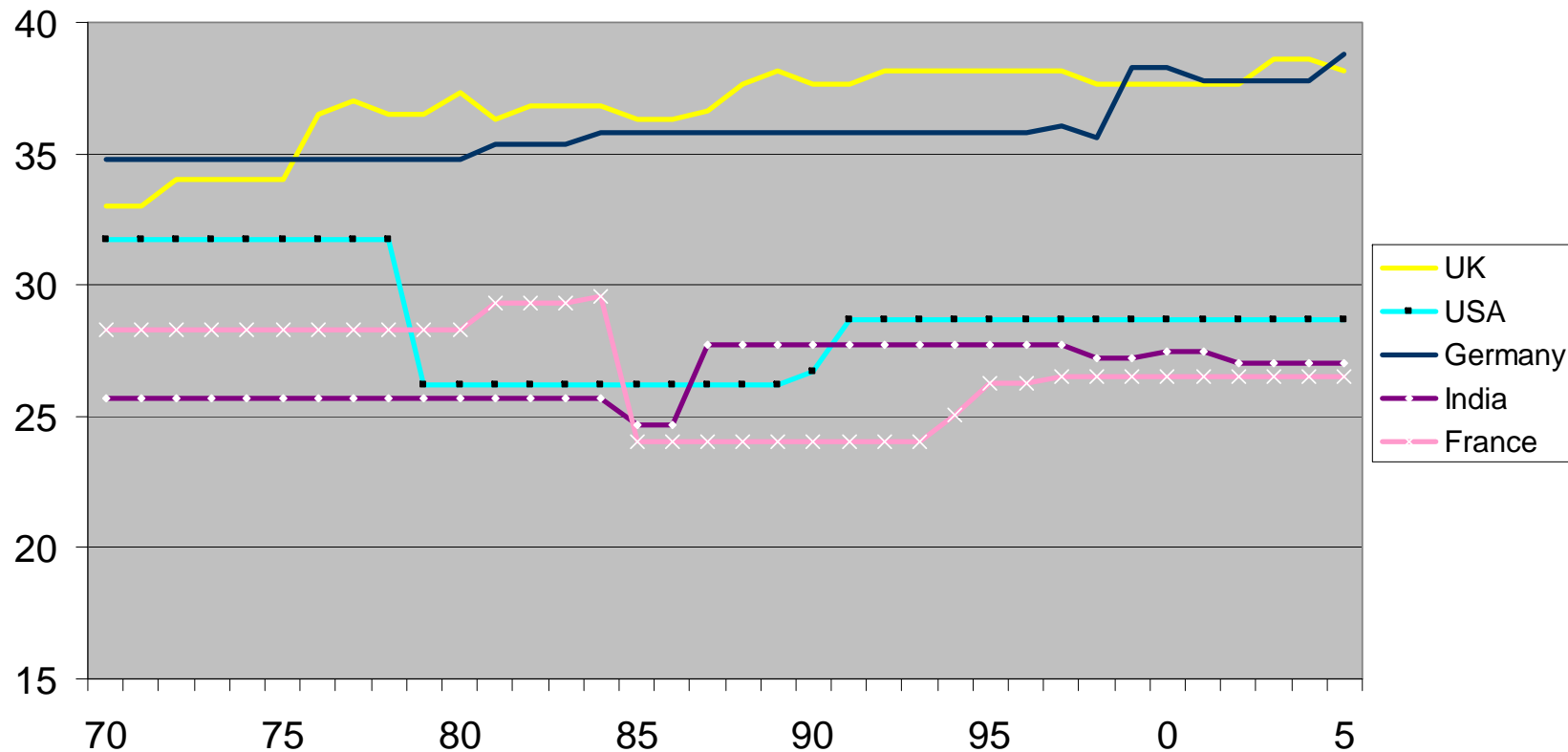
1. Quorum threshold (1)
 2. Supermajority requirements for major transactions (1)
 3. One share-one vote (3)
 4. Cumulative voting for directors (1)
 5. Prohibition on self-interested voting (1)
 6. No 'squeeze out' rule (1)
 7. Right to exit (appraisal; mandatory bid etc) (3)
 8. Disclosure of major shareholding (1)
 9. Minority oppression remedies (2)
 10. Rules protecting shrs vs board are mandatory (4)
- (18 variables)



Creditor protection

1. Restrictions on debtor action
2. Creditor contract rights
3. Insolvency laws

Figure 7: Aggregate Creditor Protection (57 variables)



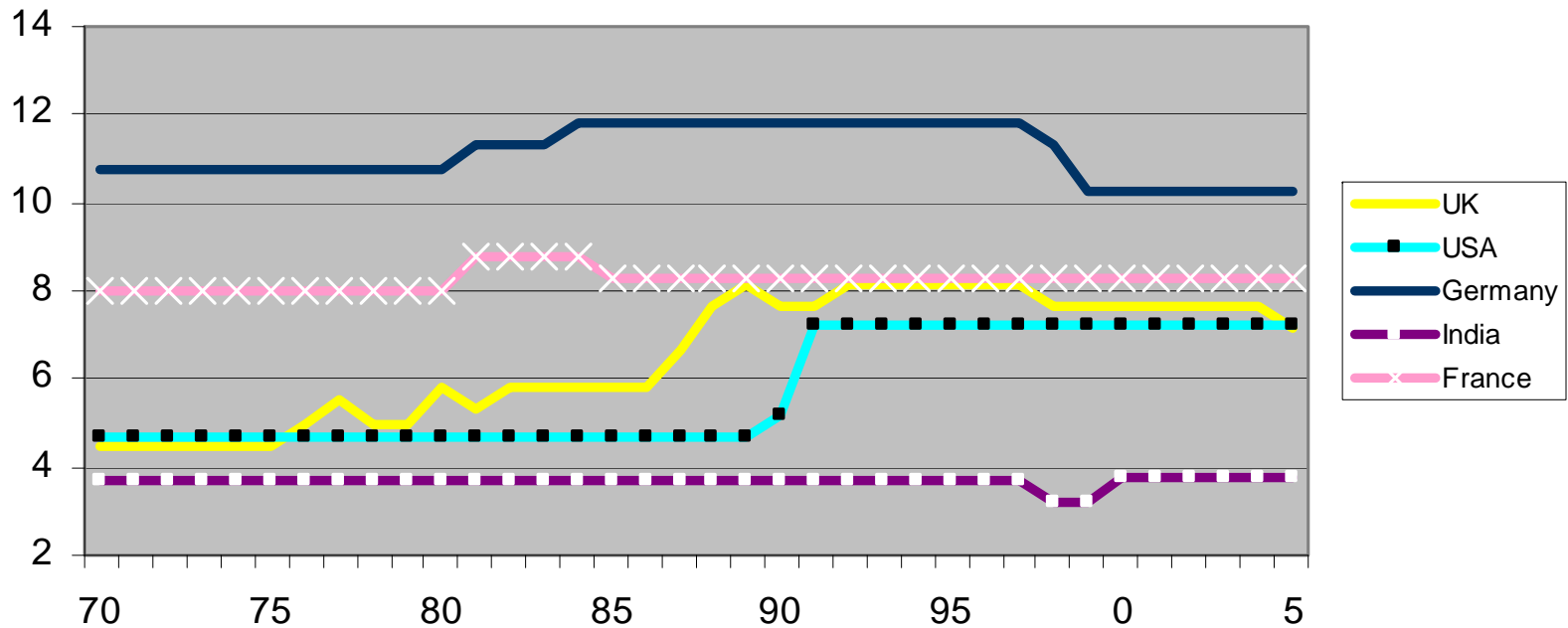
Creditor protection

(i) Restrictions on debtor action

1. Minimum capital requirements (2)
2. Dividend restrictions (3)
3. Equitable subordination of shareholder loans (1)
4. Piercing corporate veil (1)
5. Transaction avoidance in insolvency (3)
6. Directors' liability w.r.t. creditors (3)
7. Public enforcement of directors/shrs liabilities (2)

(15 variables)

Figure 8: Restrictions on Debtor Activities
(15 variables)



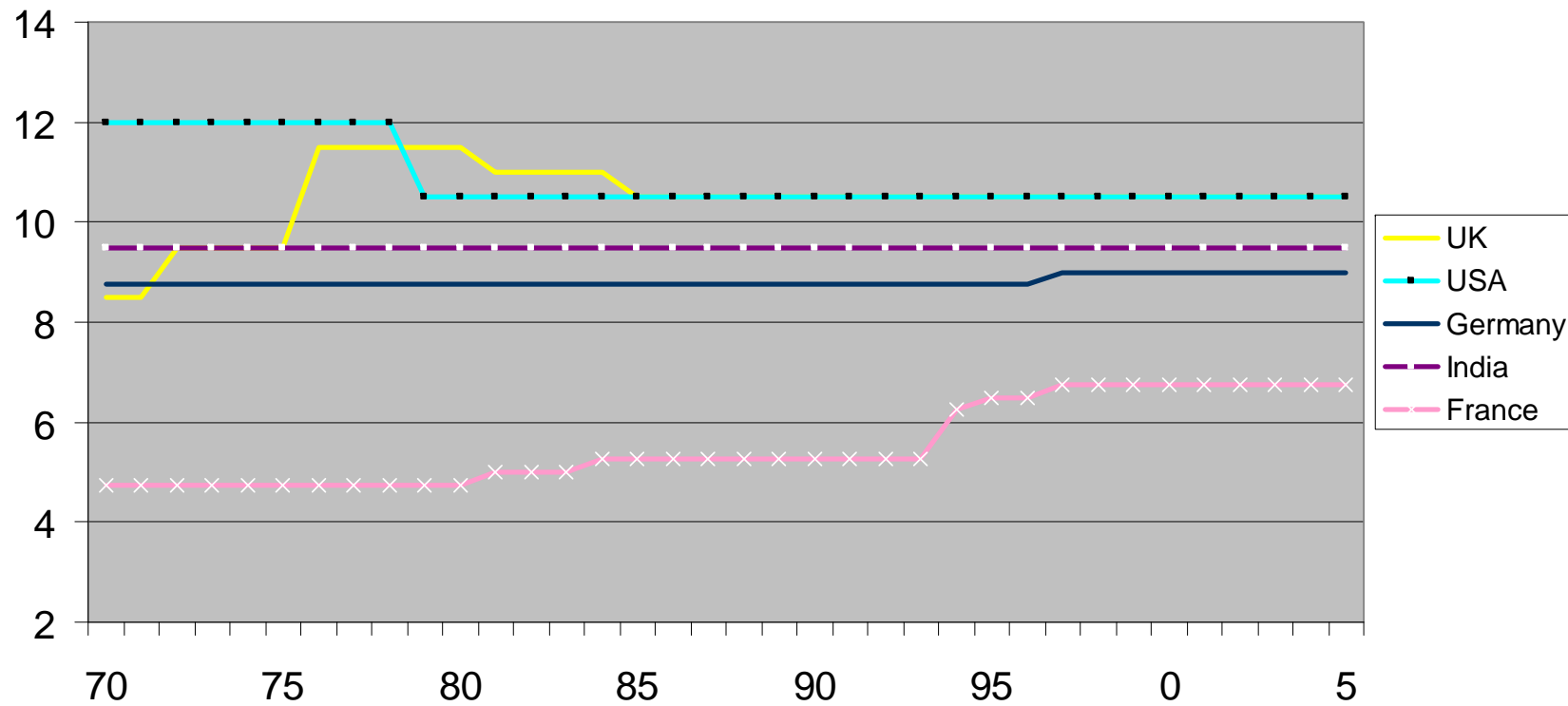
Creditor protection

(ii) Creditor contract rights

1. Set-off (2)
2. [Majority voting permitted for bond renegotiation? (1)]
3. Enforcement (3)
4. Availability of security interests (5)
5. Effectiveness of retention of title (2)
6. Registration of security interests (1)

(13 variables)

**Figure 9: Creditor contract rights
(13 variables)**



Creditor protection

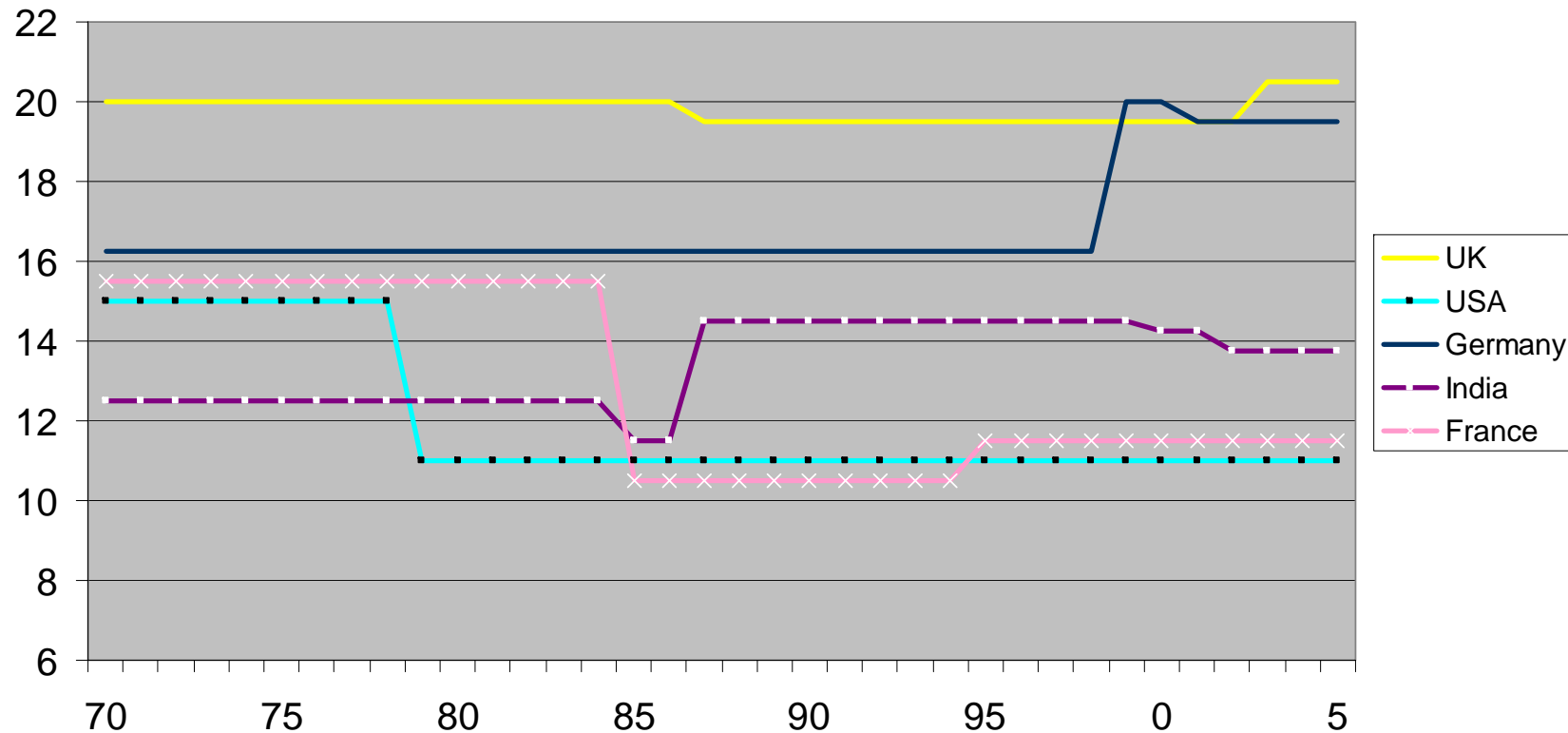
(iii) Creditor rights in insolvency

1. Structure of proceedings (1)
2. Triggering insolvency proceedings (10)
 1. Duty on directors to file (1)
 2. Ease with which creditor can file (2)
 3. Ease with which debtor can file reorganisation (3)
 4. Control over choice of procedure (4)
3. Stay/ moratorium in liquidation (2)
4. Stay/ moratorium in rehabilitation (2)
5. Director control in rehabilitation? (1)
6. Appointment of controller (5)
7. Voting on plan for exit (5)
8. Priority ordering (3)

(29 variables)

Creditor rights in insolvency

Figure 10: Creditor rights in bankruptcy
(29 variables)

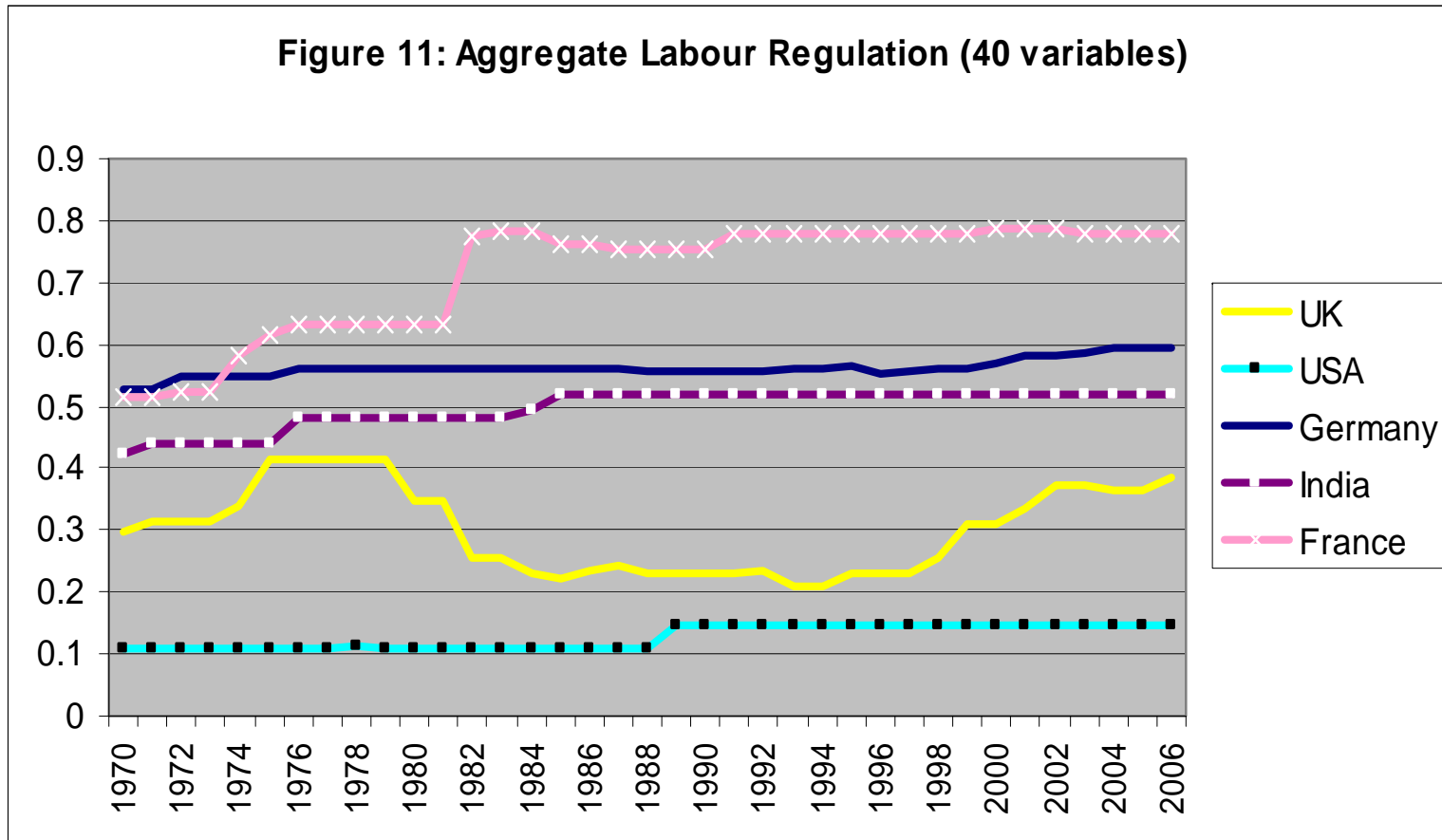


Labour regulation

Alternative employment contracts
Working time
Dismissal
Employee representation
Industrial action

(see Deakin, Lele and Siems, 'The evolution of labour law', forthcoming, *International Labour Review* and CBR WP series)

Figure 11: Aggregate Labour Regulation (40 variables)

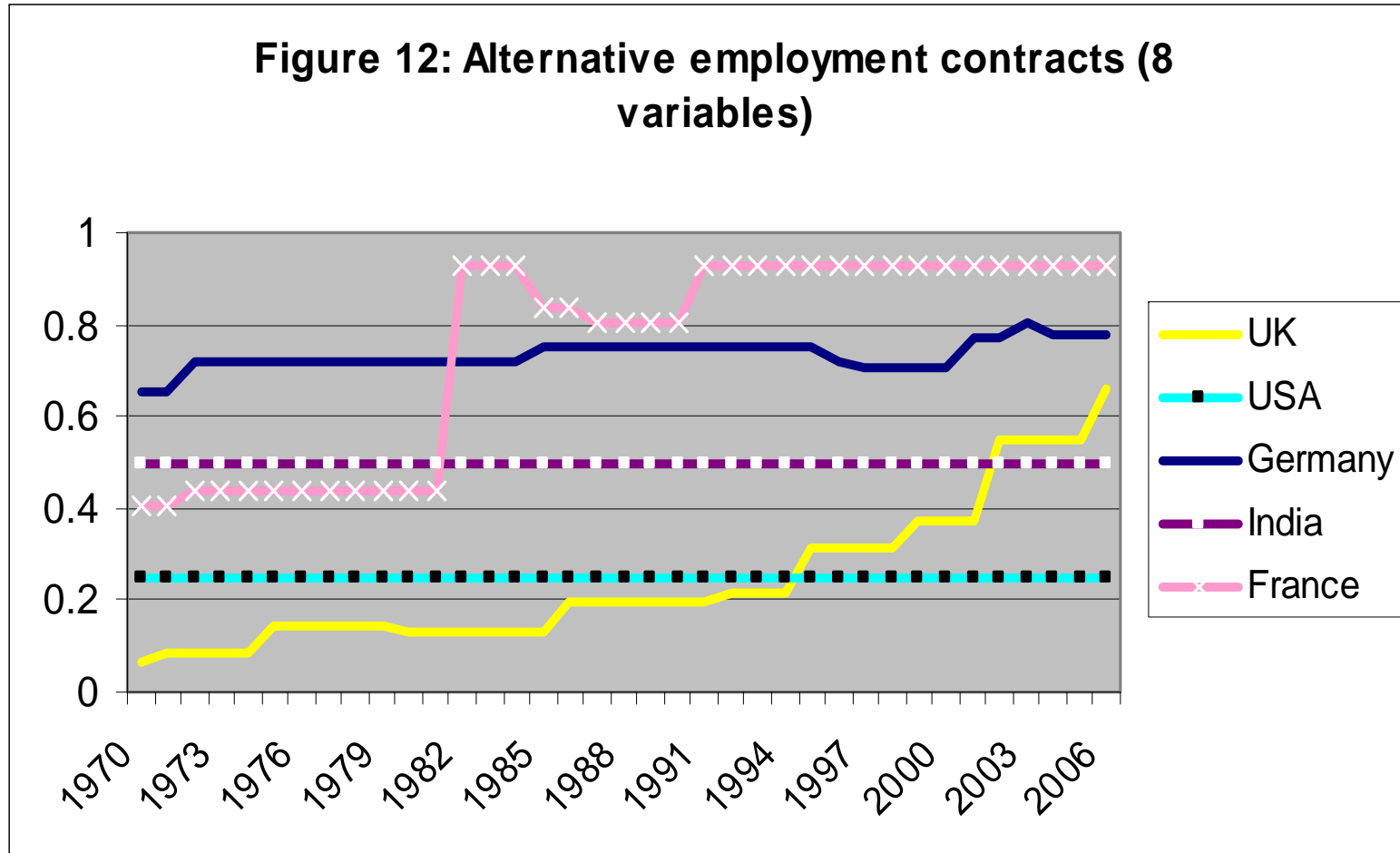


Alternative employment contracts



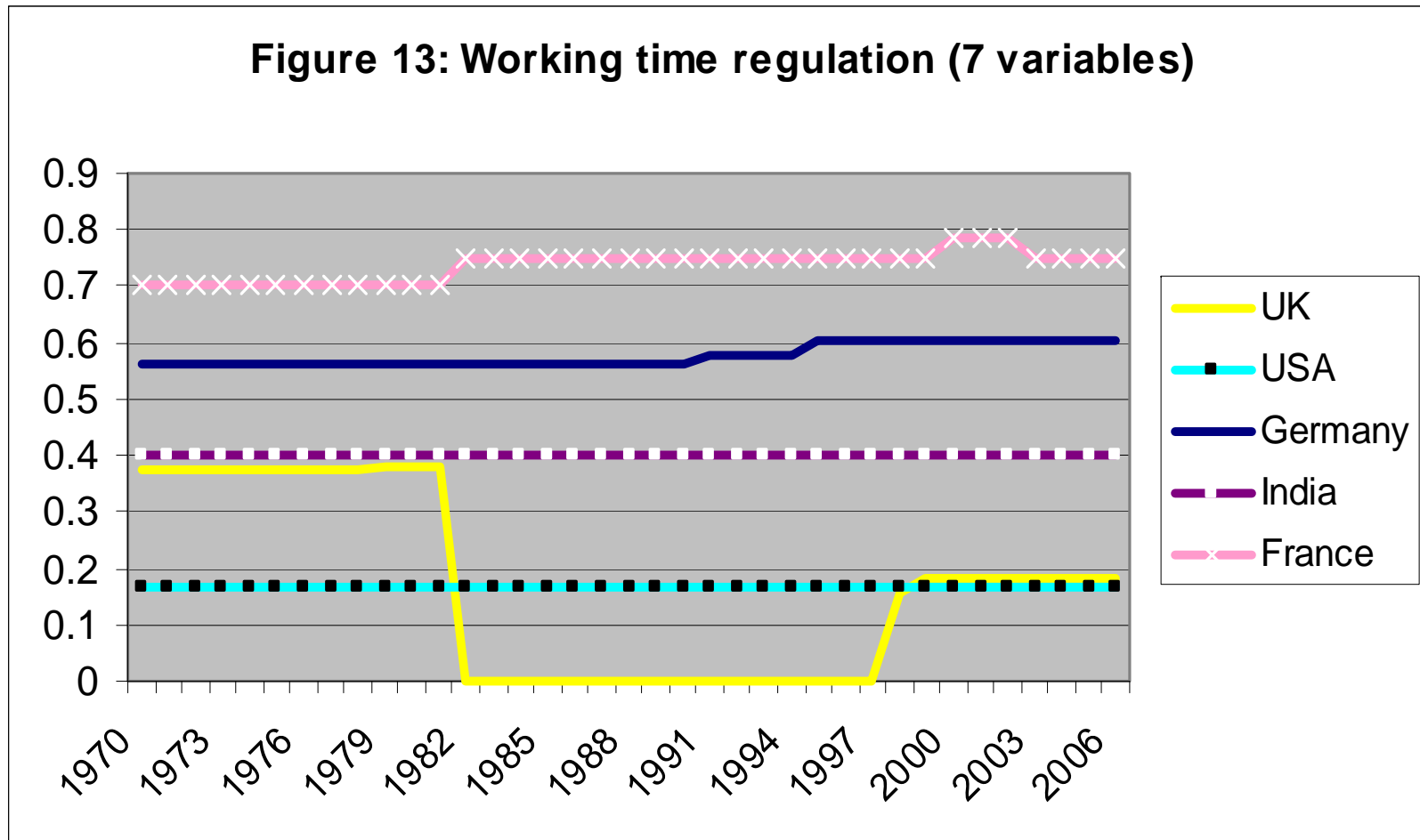
1. Choice of employment or self-employment, etc.
2. Equal treatment for part-time workers
3. Cost of dismissing part-time workers
4. Controls on use of fixed-term contracts
5. Equal treatment for fixed-term workers
6. Maximum duration of fixed-term contracts
7. Control of agency work
8. Equal treatment for agency workers

Figure 12: Alternative employment contracts (8 variables)



1. Annual leave
2. Public holidays
3. Overtime premia
4. Overtime limits
5. Weekend working
6. Normal working week
7. Maximum hours per day

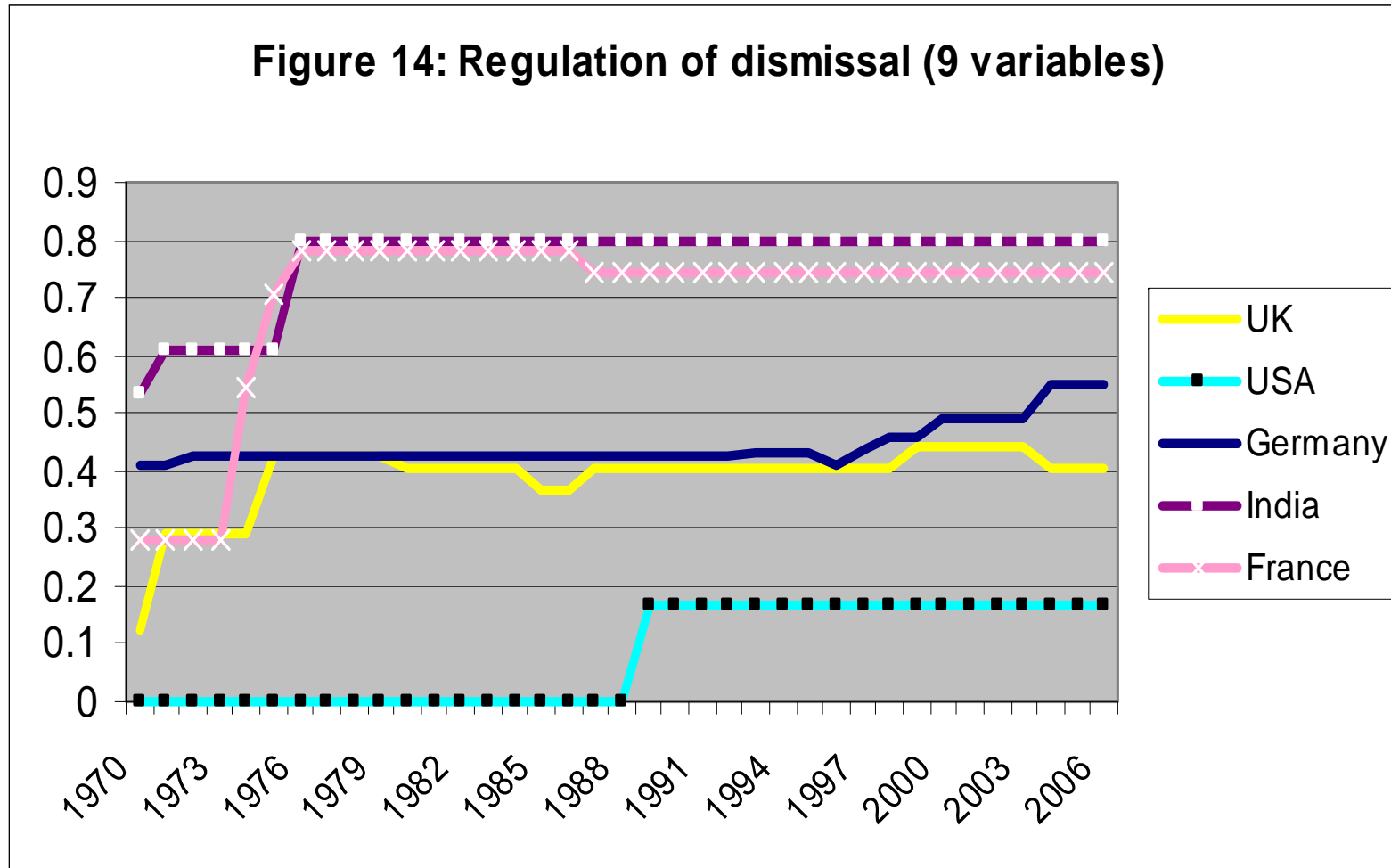
Figure 13: Working time regulation (7 variables)



Regulation of dismissal

1. Notice period
2. Redundancy compensation
3. Qualifying period
4. Procedural controls
5. Substantive controls
6. Remedies
7. Notification
8. Selection
9. Priority in re-employment

Figure 14: Regulation of dismissal (9 variables)

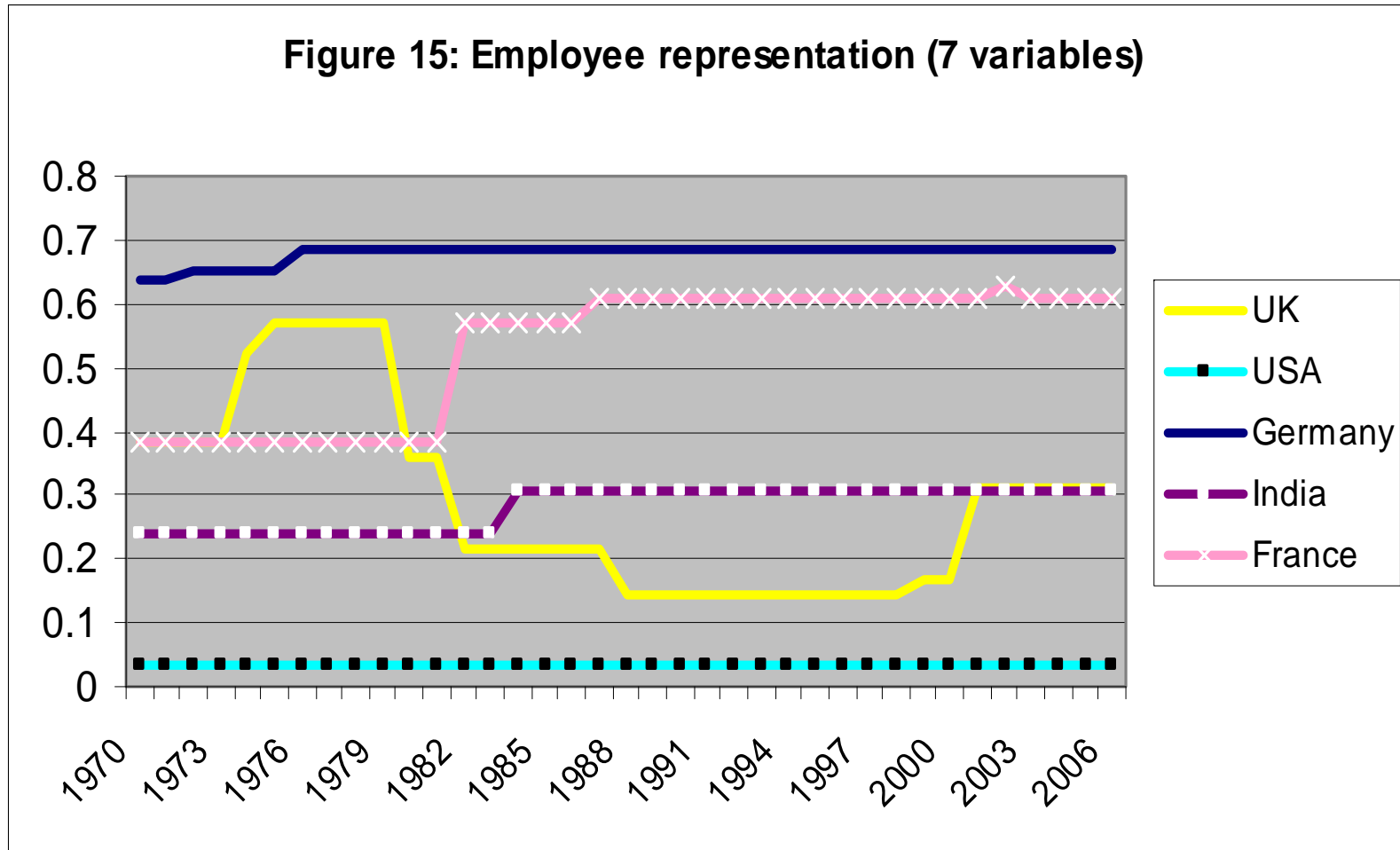


Employee representation



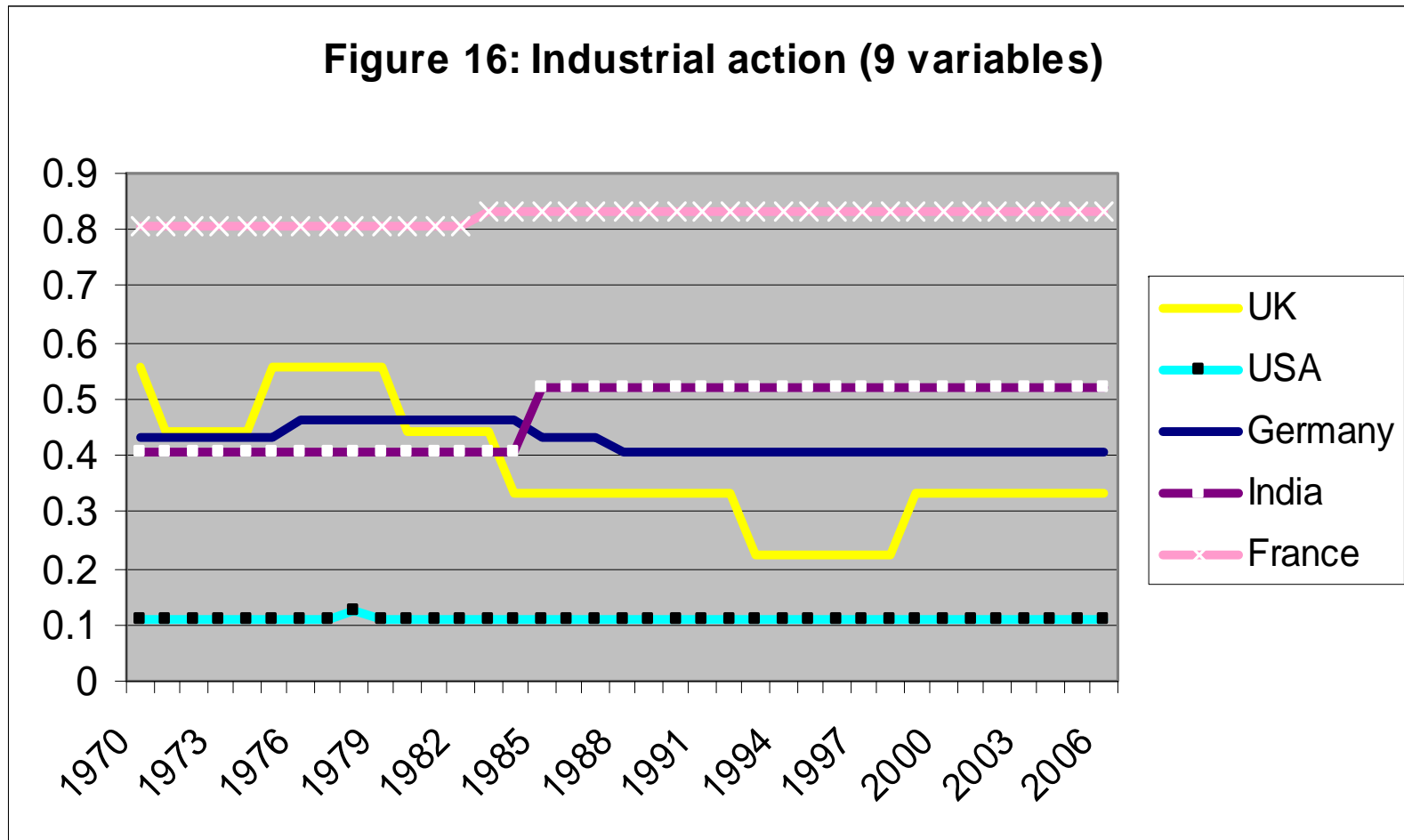
1. Right to unionisation
2. Right to collective bargaining
3. Duty to bargain
4. Extension of collective agreements
5. Closed shop
6. Codetermination: board level
7. Codetermination: works councils/information and consultation

Figure 15: Employee representation (7 variables)



- Unofficial action
- Political action
- Secondary action
- Lock-outs
- Right to industrial action
- Waiting period
- Peace obligation
- Compulsory conciliation or arbitration
- Replacement of striking workers

Figure 16: Industrial action (9 variables)



Direction

1. Shareholder rights vs board have increased in all countries
2. Rights vs majorities have not changed to same degree
3. Creditor rights: uncorrelated developments
4. Labour regulation: common law/civil law divide at aggregate level breaks down once index is decomposed; no clear evidence of legal origin effect

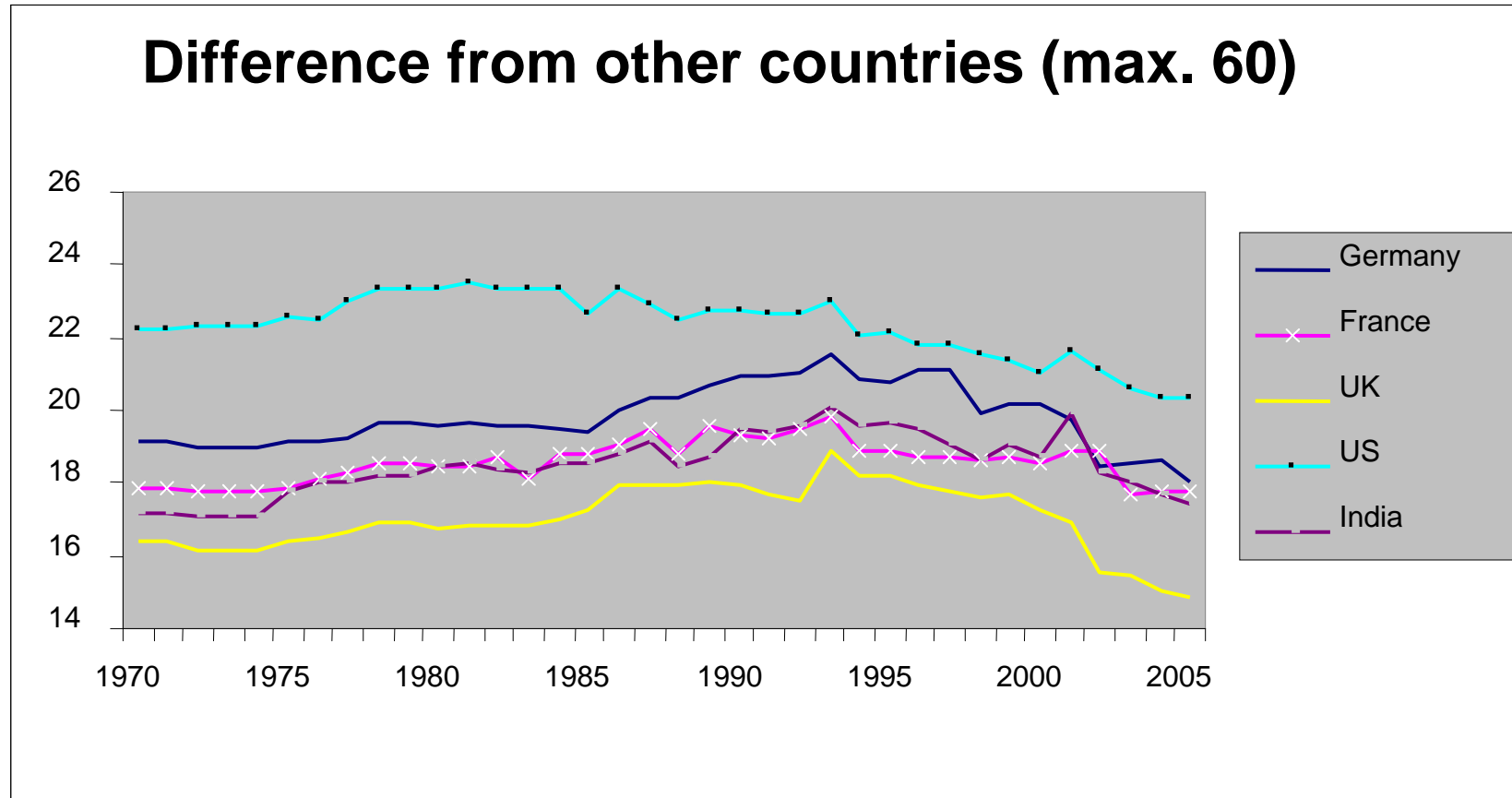
Pace

1. In all countries, change is by infrequent leaps, rather than frequent incremental steps
2. No evidence of distinctive evolutionary styles of common vs civil law (cf perhaps UK in some cases)
3. Area of law affects pattern & direction of change more than legal origin

Convergence?

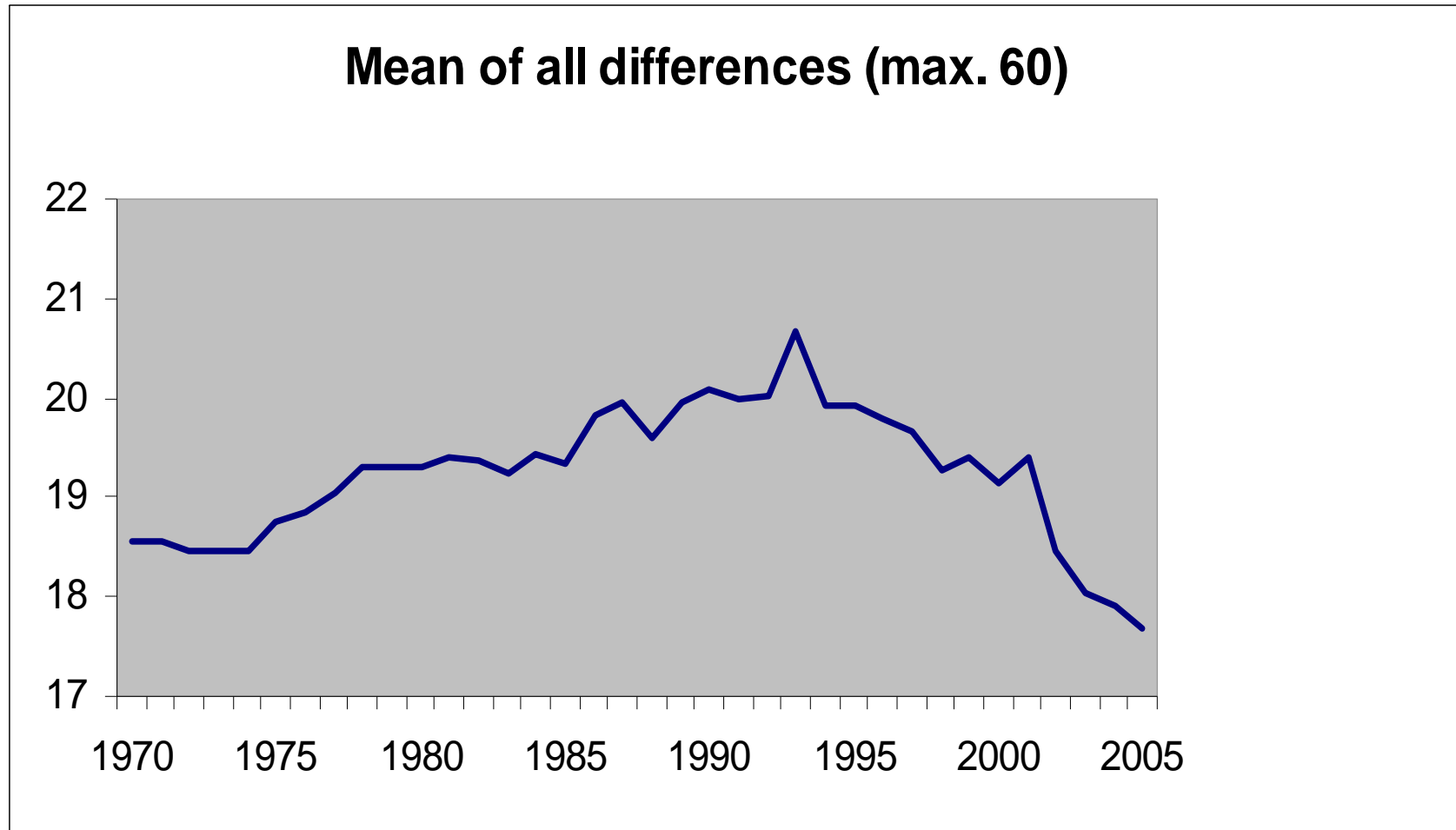
Are codings for individual variables getting more or less similar over time?

Convergence/divergence? (shareholder rights)



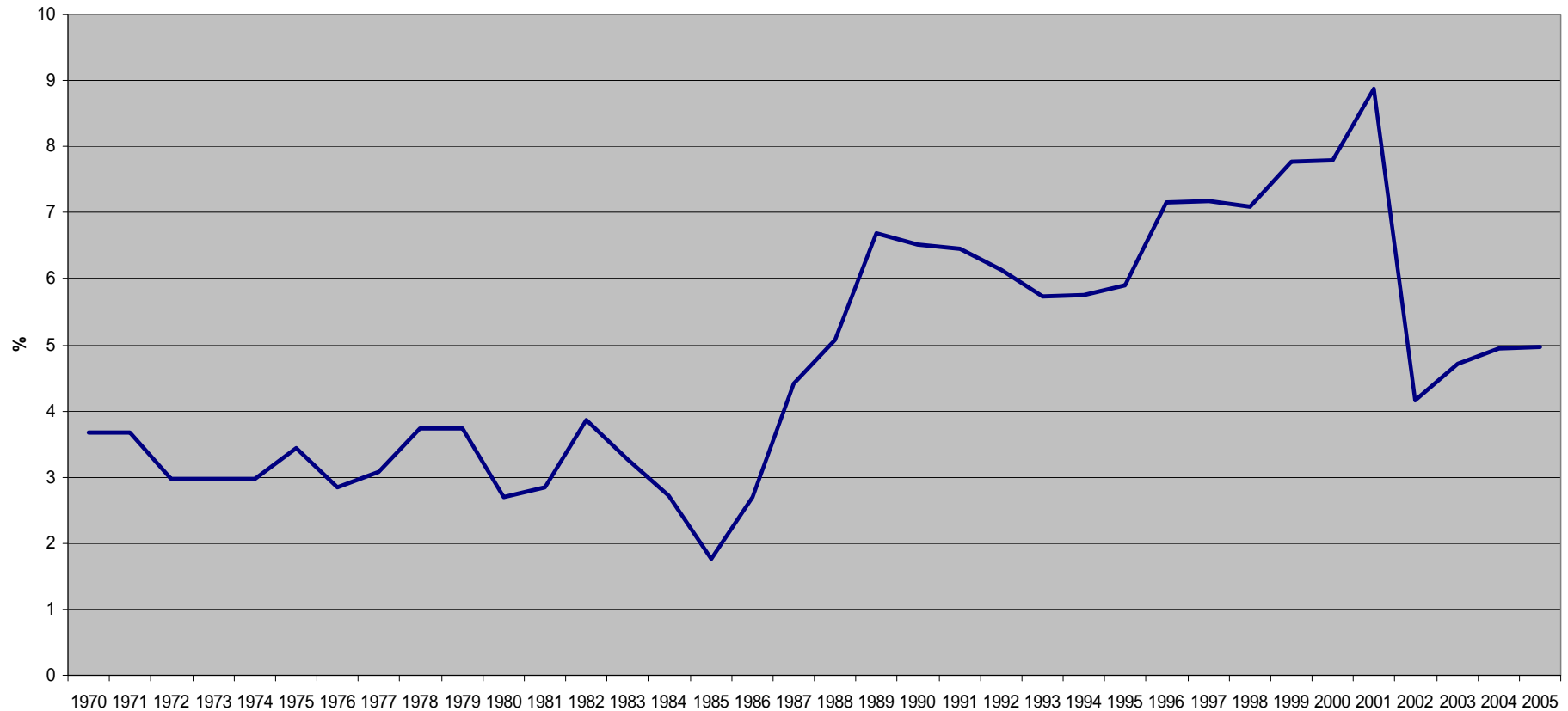
*Component differences:
Means of sum of absolute differences in (60) variables
from each of four other countries*

Extent of convergence (shr rights)



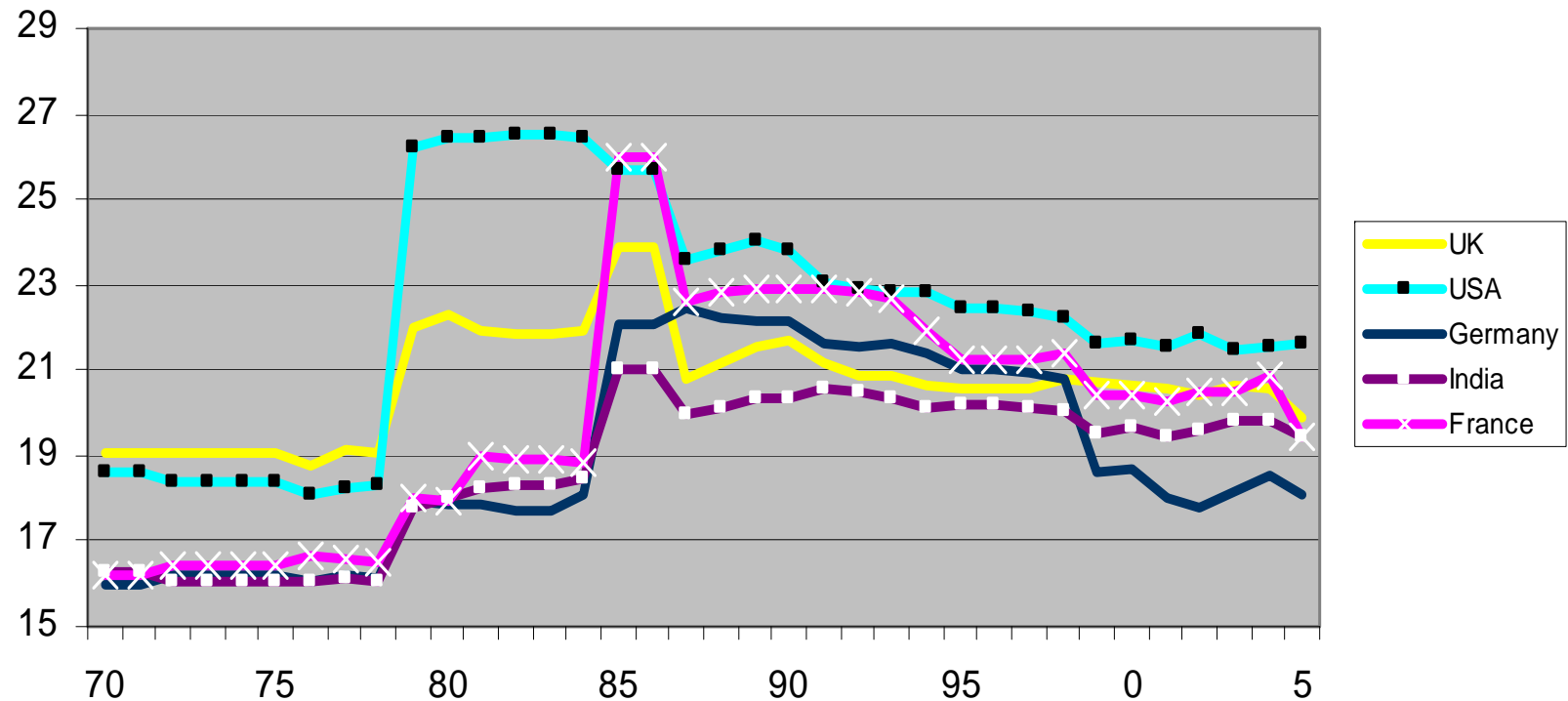
Coefficients of variation (aggregate scores)

Coefficients of variation: Shareholder protection index scores



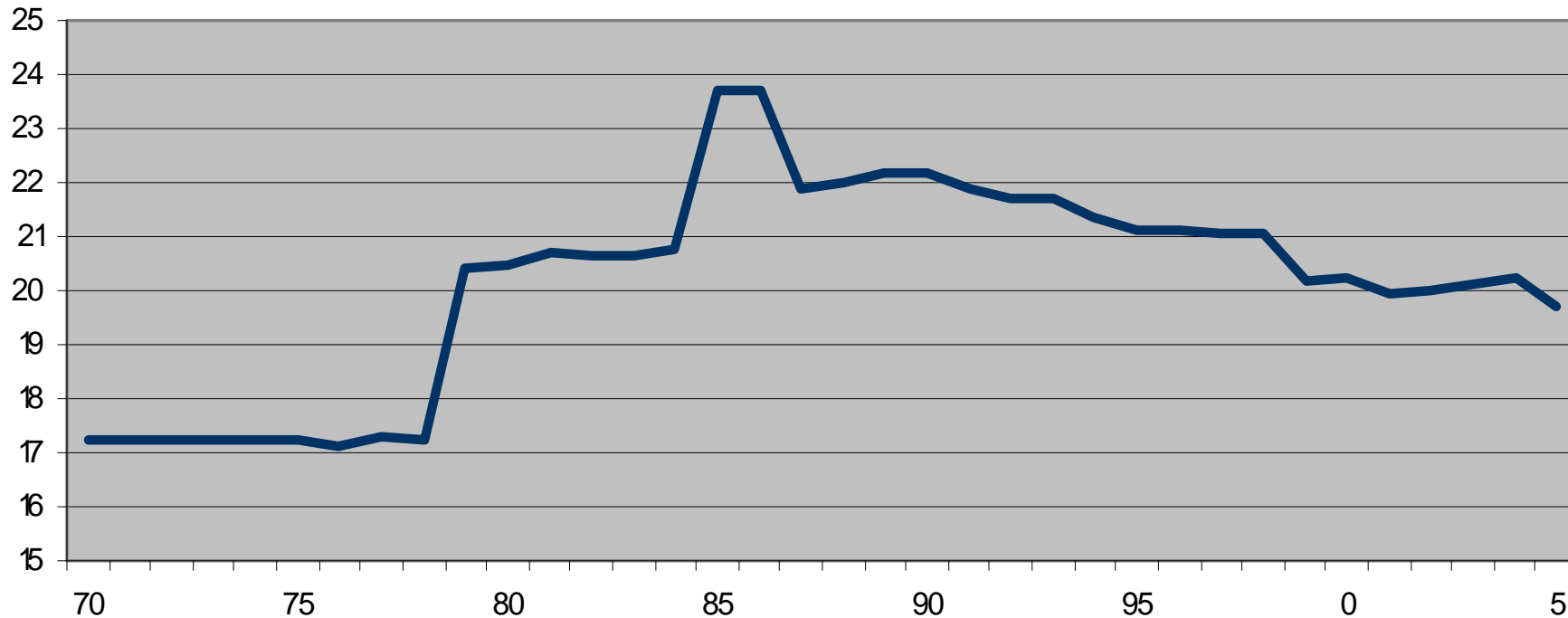
Convergence/divergence? (Creditor rights)

Differences from other countries



*Component differences:
Means of sum of squares of differences of (57) variables
from each of four other countries*

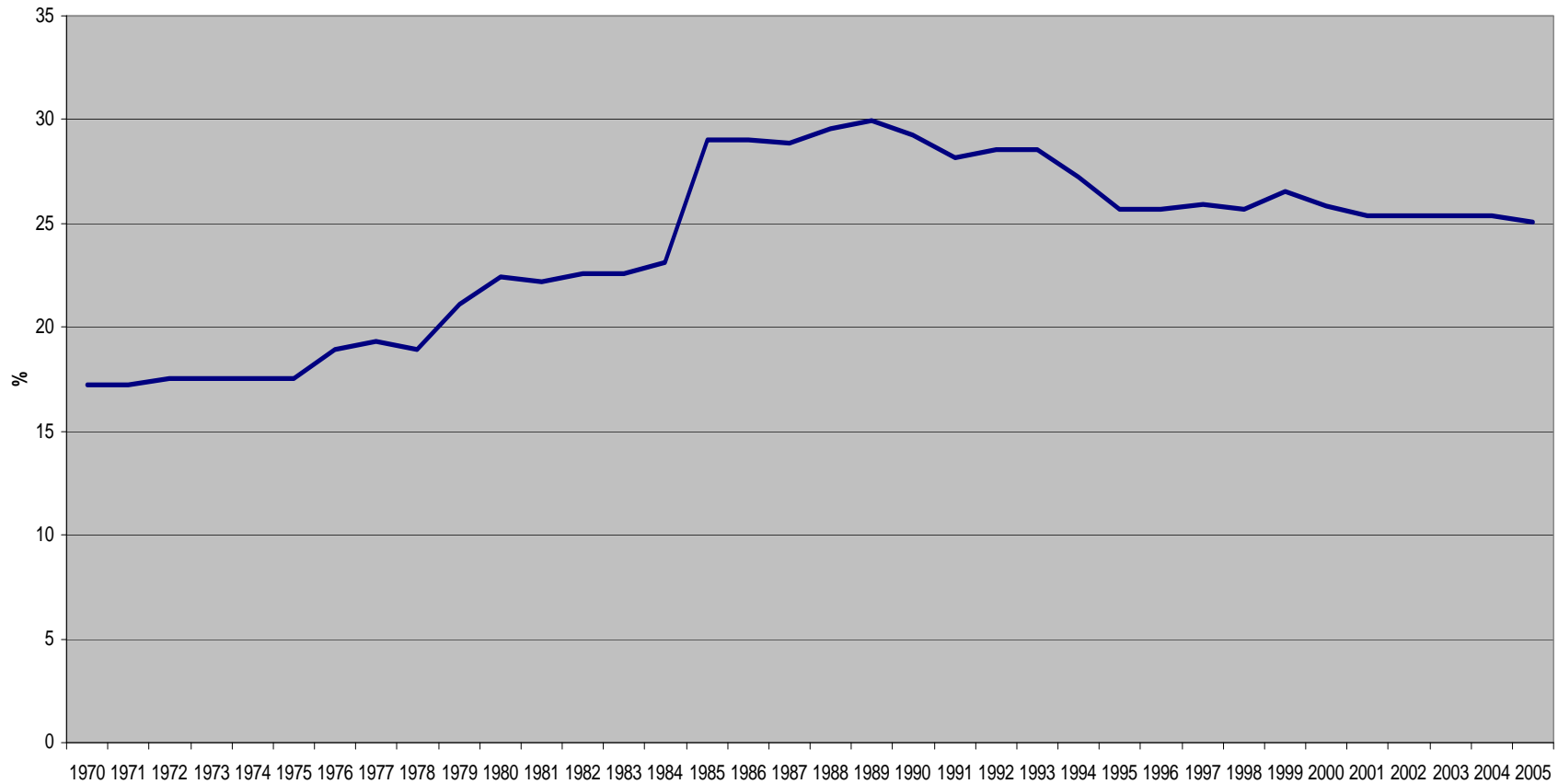
"Mean of all differences"



Mean of previous slide

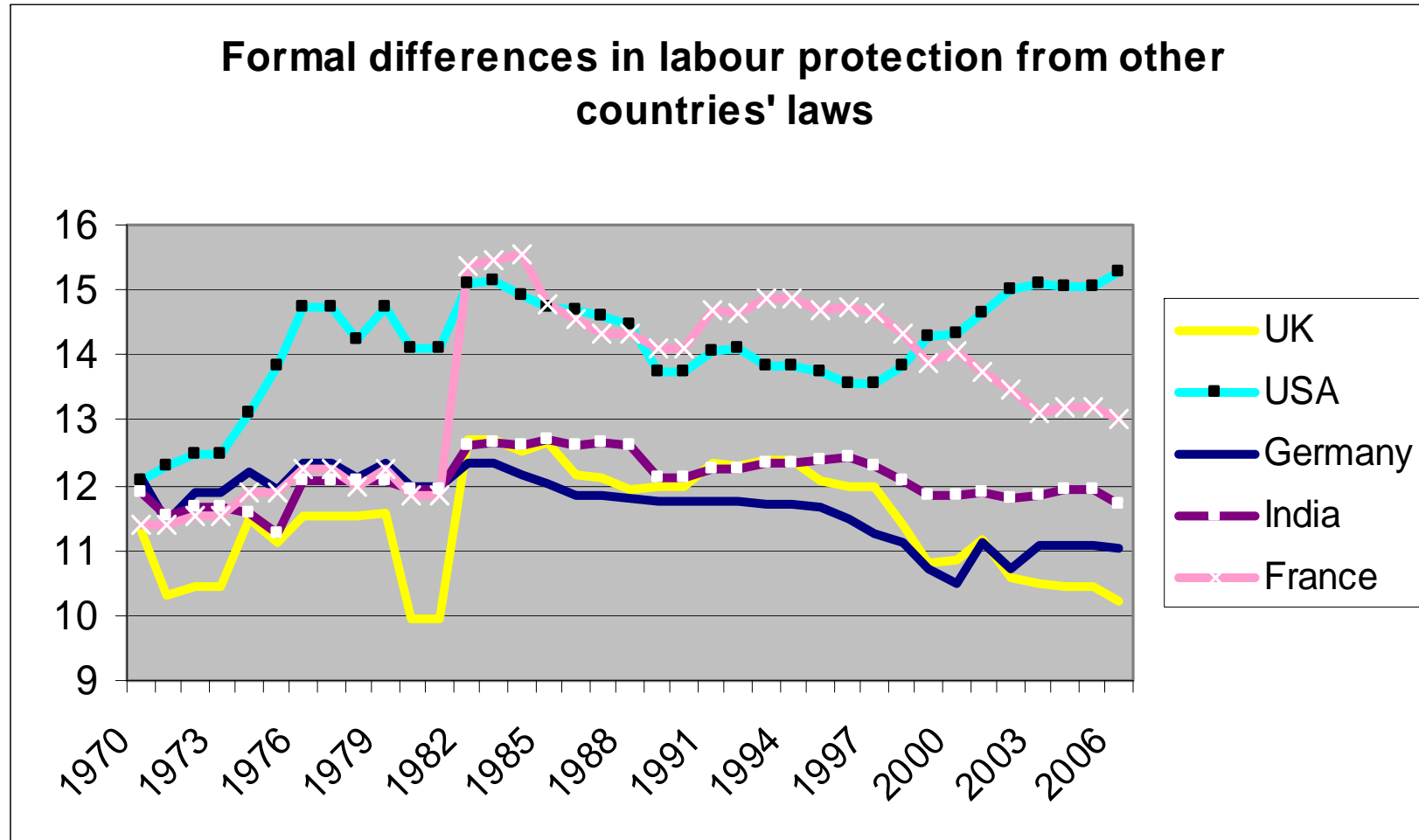
Coefficients of variation (aggregate scores)

Coefficients of variation: Creditor protection index scores

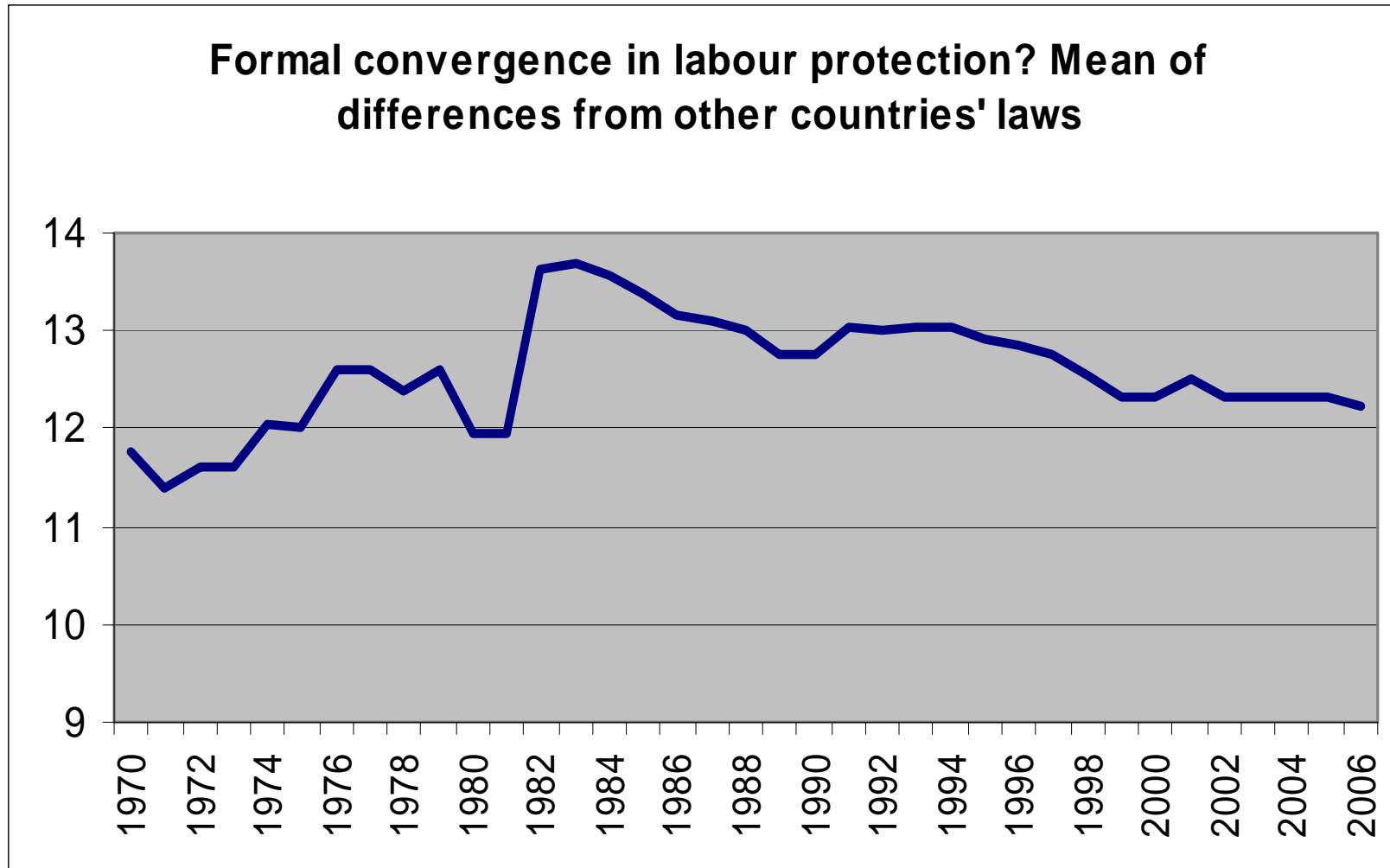


*Aggregate differences:
Coefficients of variation of aggregate sums of
creditor protection in 5 countries*

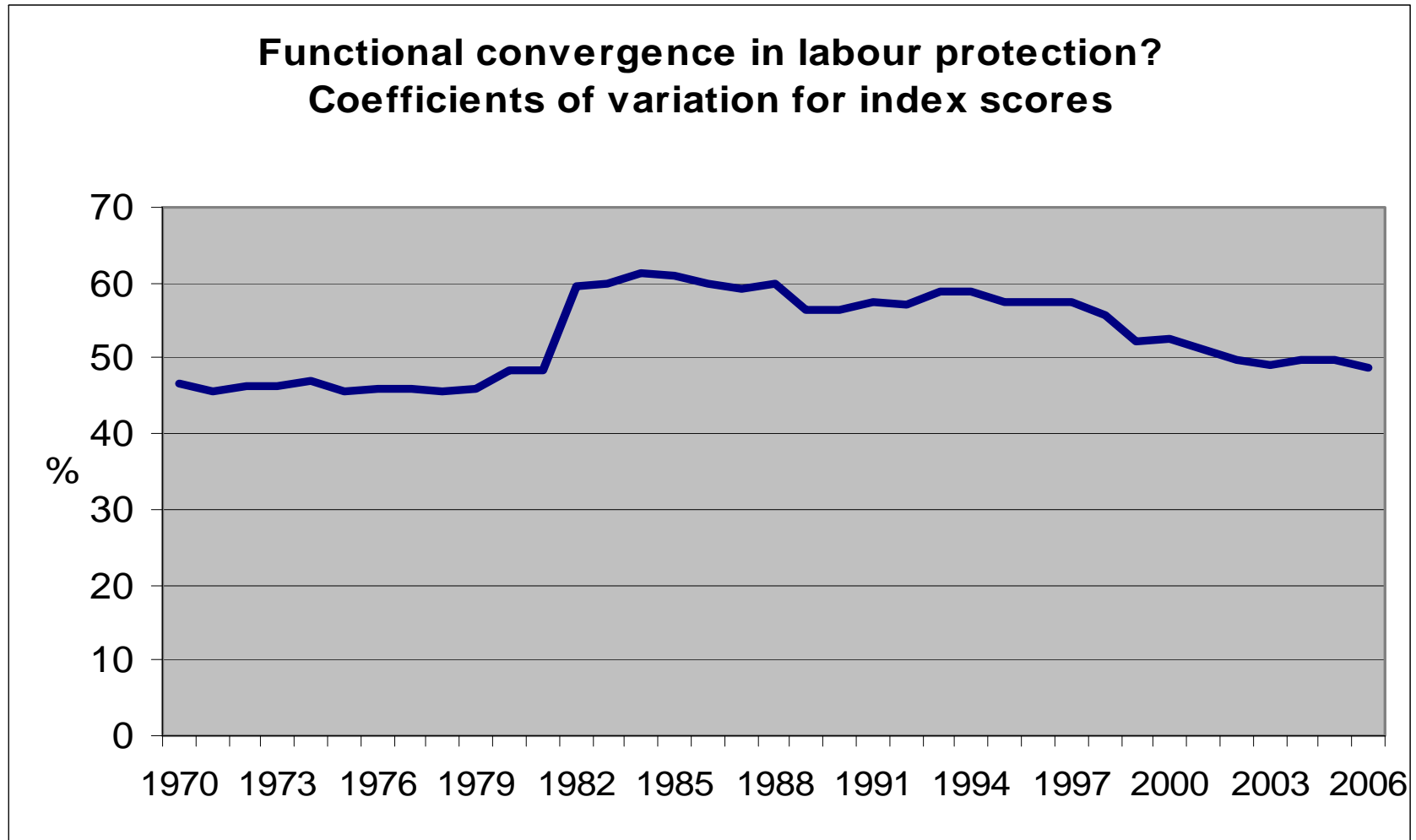
Convergence in labour law?



Formal convergence



Functional convergence



Convergence/ divergence

- Convergence is occurring in shr rights
- Much more limited as respects creditor rights and labour regulation
- Late 80s/early 90s a turning point for convergence

=>Path dependencies are stronger for creditor rights and labour rights than shr rights

Why?

1. Demand side: shr rights are more in the nature of a standard form contract (offered via public markets);, creditor rights more individually negotiated;
2. Supply side: anti-director rights are a 'costless sacrifice' for blockholders in concentrated ownership regimes; creditor rights, establishing priorities, have greater distributional consequences
3. 'Fad effect' in corporate law; no equivalent for creditor rights and labour regulation

Conclusions (so far...)



1. Doubt cast on 'legal origins' claim
 - Evolutionary trajectory of shr rights is similar across legal origin
 - Trajectories of creditor rights differ, but not by legal origin
 - Labour rights: some sign of origin effect but vanishes when sub-indices are examined
2. Doubt cast on 'adaptability' channel
 - By panel data on legal institutions
3. Evidence of convergence in 'law on the books' (for shareholder rights)
4. Limitations of quantitative methodology
 - Lack of robustness of results?

Next Steps

- Econometric analyses of panel data to (i) check robustness of quality of law and legal origins claims; (ii) address causality issues
 - Fagnas, Sarkar and Singh (2007), Armour, Deakin, Siems, Sarkar and Singh (2007): no +ve association between shr rights indexes and stock market turnover for 5 countries 1976-2005, nor for larger sample of 20 countries, 1995-2005, although in the latter case there is some evidence of a legal origin effect in terms of legal diffusion