**IIRA 2009 Study group**
**Labour market regulations: rationales, indicators and impacts**

# The Legal Origins debate: Theoretical and empirical observations from an Asia-Pacific Perspective

Sean Cooney, Peter Gahan and Richard Mitchell

The rapidly expanding legal origins literature has brought comparative law from relative obscurity to a central place in international debates about business and labour market regulation. Much of this literature supports a neo-liberal agenda. It has underpinned many policy recommendations by international agencies, the most prominent example being the World Bank's *Doing Business* publications. As *Doing Business* demonstrates, the legal origins literature has generated a profusion of indices, which have generally pointed toward the allegedly inferior economic performance of civil law countries (especially those derived from French law) in comparison with 'market-friendly' common law jurisdictions.

The publication which has done most to initiate debate on legal origins literature among labour scholars is *The Regulation of Labor (TROL),* a 2004 piece by the economists Botero, Djankov, La Porta, Lopez-de-Silanes and Shleifer.[1] The authors analysed labour and social security law in 85 countries by scoring each country in relation to a number of variables based on specific legal rules. Each country was assigned a value between zero and one for each variable. The more a law purported to protect labour (or, in the estimation of the authors, the more it imposed a cost on employers), the higher the value it was assigned. For example, one variable examined the extent to which alternatives to the 'standard employment relationship' were legally permissible. If the labour law of a particular country placed considerable restrictions on the engagement of workers on a non-standard basis – such as prohibiting the use of fixed term contracts for ongoing tasks – a value close to one would be assigned.

The scores on each of the variables were aggregated in relation to three areas: employment laws; collective relations laws and social security laws. The authors found that there was a strong relationship between high aggregate scores and legal origin, much stronger even than the relationship between labour laws and the political orientation of the enacting government. Overall, the civil law countries, and especially those of French origin, were much more protective (or, from the authors' point of view, costly to business) than those of common law origin.[2]

The authors went on to consider correlations between these aggregate variables and several indicators relating to the health of a country's labour market (including size of the unofficial economy, workforce participation and employment rates). They found that the more protective labour regulation associated with the civil law countries had generally 'no benefits, and some costs'[3] These costs included a larger informal sector,

[1] Botero, J, Djankov, S, La Porta, F, Lopez-de-Silanes, F and Shleifer, A (2004) 'The Regulation of Labour,' *Quarterly Journal of Economics*, 119: 1339-1382.
[2] The authors contrast New Zealand and Portugal.
[3] At 1375.

higher unemployment (especially youth unemployment) and lower male workforce participation. These results tallied with a number of other studies claiming negative effects for extensive labour market regulation.[4]

The analysis in *TROL* was soon taken up by the World Bank in its *Doing Business* project (created by Simeon Djankov, one of the co-authors). Its Employing Workers Index, based on the employment law variables in *TROL*, ranks countries according to the degree to which their labour laws allegedly impede business. Countries are praised for making working hours more flexible, reducing compensation for dismissal and reducing restrictions on non-standard work. In 2009, for instance, Azerbaijan and Burkino Faso were complimented for easing restrictions on fixed term contracting and removing dismissal requirements. On the other hand, China was criticised for making dismissal more difficult (because of its landmark Labour Contract Law), the United Kingdom for increasing paid annual leave, and Sweden and Korea for increasing restrictions on fixed term employment.[5]

It is important to appreciate that *TROL* is simply one aspect of a far-reaching claim about the nature of economic regulation as whole (just as the Employing Workers Index is just one of many indices constituting *Doing Business*). Three of the *TROL* authors (La Porta, Lopez-de-Silanes and Shleifer) have been leading proponents of this wider claim. In a survey of the legal origins literature published last year,[6] they draw on *TROL* and many other studies employing a similar 'leximetric'[7] approach. These studies examine the relationship between legal origin on investor protection, the regulation of the business enterprise and judicial enforcement of contractual and property rights. They observe:

> In all these spheres, civil law is associated with a heavier hand of government ownership and regulation than common law. Many of [the] indicators of government ownership and regulation are associated with adverse impacts on markets, such as greater corruption, larger unofficial economy, and higher unemployment.[8]

The explanation for this correlation is said to lie in a legal tradition constituting an 'involuntary transmission of different bundles of information across human population'.[9] Drawing on comparative law theory, the legal origins scholars observe that when a legal tradition is transplanted (say from France to Portugal, Germany to Korea or England to New Zealand), it is not only 'blackletter' laws which are conveyed but also the underlying features of the originating system, such as its

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[4] See, e.g. Haltiwanger, John, Stefano Scarpetta, and Helena Schweiger "Assessing Job Flows across Countries: The Role of Industry, Firm Size, and Regulations." World Bank Policy Research Working Paper 4070, 2006; Heckman, James J., and Carmen Pagés. "Law and Employment: Introduction." in *Law and Employment: Lessons from Latin America and the Caribbean*, ed. James J. Heckman and Carmen Pagés, 1–107. Chicago and London: University of Chicago Press, 2004; Poschke, Markus, 'Employment Protection, Firm Selection and Growth', IZA Discussion Paper 3164.

[5] World Bank, *Doing Business 2009*

[6] Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "The Economic Consequences of Legal Origins" (2008) 46 *Journal of Economic Literature* 285–332

[7] See Priya Lele and Mathias Siems , Shareholder Protection – A Leximetric Approach, (2007) 7 *Journal of Corporate Law Studies* 17-50 (together with P. Lele); Mathias Siems Numerical Comparative Law – Do We Need Statistical Evidence in Order to Reduce Complexity?, (2005) 13 *Cardozo Journal of International and Comparative Law* 521-540 .

[8] At 286

[9] At 287.

distinct institutional structures, approaches to legal knowledge and ideological commitments. It is then claimed that, for historical reasons, the common law tends to limit governmental interference in markets whereas the civil law, at least from the time of Napoleon, supports stronger government intervention. These differing ideologies, which have been transmitted around the globe through colonization and adoption, continue to exert a powerful impact today, outweighing even political influences (such as whether a country has a social democratic or neo-liberal government).

While the authors consider that the diverse regulatory patterns are likely to continue, they predict continue movement towards the 'market-supporting regulation' favoured by common law systems. The timing of this prediction has proved to be a little unfortunate since it rested on the assumption that the world economy 'remains free of war [or] major financial crises', circumstances under which they acknowledge civil law approaches to regulation may be advantageous.[10]

The Global Financial Crisis notwithstanding, it would seem that the legal origins literature will continue to exert a powerful influence on scholarship in the social sciences. It will also have tangible policy outcomes through the interventions of the World Bank and other agencies in developing countries in particular.

Unsurprisingly, given its negative view of civil law jurisdictions and of government intervention, the legal origins literature has come under intense scrutiny. Despite the increasingly sophisticated methodology of its proponents, central contentions of legal origins seem bemusing; for example, is it really the case that France, Germany, Japan, China, Sweden and Switzerland have (at least when the world is not awry) greater in-built legal impediments to economic development than the United States, India, Australia or Ireland?

The critiques have come from a variety of directions, not least from labour scholars.[11] Some question the implicit normative commitments. For example, Sangheon Lee and Deirdre McCann argue strongly that the negative evaluation of working time regulation in *TROL* and also *Doing Business* conflicts with ILO Conventions – although *Doing Business* denies this.[12] More fundamentally, there is a failure to appreciate the potential benefits of labour regulation, such as the positive health impact of limiting excessive working hours.

Another line of criticism maintains that the legal origins scholars (themselves financial economists, not lawyers) – misunderstand the legal systems that they are attempting to study. Their rather crude classification of systems into the common law and civil law traditions fails to take seriously enough the extensive comparative law literature demonstrating that the distinction between the systems is not nearly as significant as the legal origins scholars believe. For example, Katharina Pistor and her collaborators suggest that whether a country's legal system is indigenous or transplanted may be at least as significant for its legal development as its membership

[10] At 327.

[11] See the very helpful literature review by Sangheon Lee, Deirdre Mcann and Nina Torm, The World Bank's "Employing Workers" index: Findings and critiques – A review of recent evidence (2008) 147 *International Labour Review* 416

[12] See Lee, Sangheon; McCann, Deirdre. 2008. "Measuring labour market institutions: Conceptual and methodological questions on 'working hours rigidity'", *in* Janine Berg and David Kucera (eds): *In Defence of Labour Market Institutions: Cultivating justice in the developing world*. Houndmills, Palgrave Macmillan, pp. 32–63.

of a particular legal family.[13] Moreover, processes of globalisation cut across the civil law/common law distinction.[14] A further criticism is that the legal origins scholars mistake the purpose of civil law codes, which are to systematise, not regulate.[15] Indeed, Ralf Michaels has suggested that the 'legal origins' scholars are misnamed in that they are really interested in the degree of deregulation in a legal system, not its origin.[16]

A third form of critique agrees with the legal origins scholars that a 'leximetric' approach to comparative law (including comparative labour law) might yield interesting insights, but argues that the leading legal origins exponents have made multiple methodological errors. Simon Deakin and Mathias Siems and their collaborators have identified, and sought to correct, many of these errors. They have begun to produce their own leximetric data in relation to shareholder, creditor and worker protection. These results come to quite different conclusions from the legal origins scholars.[17] They point to the following weaknesses in the legal origins literature:

1. It compares formal legal rules rather than (as is usual in comparative law methodology) functional equivalents.
2. The variables are biased towards the US legal system and overlook important legal devices in civil law jurisdictions, with the result that they benchmark legal systems against the US, rather than a neutral standard.
3. The variables are simply aggregated, even though they may not be equally important.
4. Some countries seem to be simply wrongly categorised. For example, it is not clear why Thailand should be categorised as a common law country, since it maintains civil codes nor why China should be classified as socialist in 2004 and then as part of the German civil law family by the same authors in 2008.
5. The keys laws studied by legal origins scholars are statutory in both common law and civil law countries. Thus the variables examined in relation to employment are largely the product of government regulation in both France and Germany on the one hand, and the United Kingdom and Australia on the other.
6. Much legal origins research is not longitudinal (although recent research has attempted to correct this). Thus it fails to capture developments *within* legal systems over time.

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[13] See, e.g. Pistor, K, Keinan, Y, Kleinheisterkamp, J and West, M 'The Evolution of Corporate Law: A Cross-Country Comparison' (2003) 23 *University of Pennsylvania Journal of International Economic La*w, 23: 791-871.

[14] See John Braithwaite and Peter Drahos, *Global Business Regulation*, Cambridge University Press 2000.

[15] Ralf Michaels, ' The Second Wave of Comparative Law and Economics?' (2009) 59 *University of Toronto Law Journal* 197.

[16] Id at 201.

[17] See, e.g. Ahlering, B, and Deakin, S (2007) 'Labour Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complementarity?' *Law and Society Review* 41: 865-908; Mathias Siems and Simon Deakin, 'Comparative Law and Finance: Past, Present and Future Research', (2009) *Journal of Institutional and Theoretical Economics* (forthcoming, available on SSRN).

These flaws attach to at least some of the work of the legal origins scholars. However, it does not follow that the attempt to find relationships between legal rules at particular points in time and socio-economic circumstances is uninteresting or unimportant. Certainly, any attempts will be beset with methodological difficulties and be provisional. Nonetheless, in suggesting that such relationships may exist (albeit not necessarily the ones they find) the legal origins scholars have opened up intriguing possibilities for research. Are there, for example, correlations between particular legal rules (such as those regulating the labour market) and social indicators, such as those relating to poverty? Again, do reforms to particular legal rules really have much effect on economic performance? How do laws protecting workers interact with those protecting shareholders and creditors (a question closely touching on the 'varieties of capitalism' literature).[18]

We believe efforts to answer such questions are worthwhile and are therefore commencing comparative leximetric work within our region, beginning with Australia. Our work to date draws extensively from that of the Deakin-Siems analyses, but we will also seek to undertake qualitative analyses, such as in the rich historical work of Pistor and others. We have already completed a longitudinal coding of Australian labour law together with our colleagues Shelley Marshall and Andrew Stewart. This suggests that (to quote our forthcoming report) 'the timing of stages of economic development, perhaps the type of labour market and industry structure, and changes in the political environment, may be more important for explaining the direction of legal evolution than legal origins'. There is nonetheless, some evidence of a weak legal origins effect, that is that Australian labour law tends to resemble other common law jurisdictions (such as the US and UK, much less so India) more than it does civil law jurisdictions (Germany and France), but with significant variation over time.[19]

Our future work will analyse corporate law in Australia and labour and corporate law in several jurisdictions in Asia. One line of inquiry we hope to pursue involves comparisons between the common law/civil law pairs of India-China, Malaysia-Philippines and Hong Kong-Taiwan. A cursory glance at these, bearing in mind comparative economic performance, would suggest legal origin is not very relevant. We will investigate whether this is indeed the case.

[18] See Shelley Marshall, Richard Mitchell and Ian Ramsay (eds), *Varieties of Capitalism, Corporate Governance and Employees*, Melbourne University Press, 2008.

[19] We have compared our results with those reported in John Armour, Simon Deakin, Priya Lele and Mathias Siems, "How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor and Worker Protection', (2009) 57 *American Journal of Comparative Law* 579.