

CORPORATE LAW AND
INTERNATIONAL CORPORATE LAW AND FINANCIAL MARKET REGULATION
INTERNATIONAL CORPORATE LAW AND FINANCIAL
INTERNATIONAL CORPORATE LA
INTERNATIONAL CORPORATE LAW AND FINANCIAL MARKET REGULATION
INTERNATIONAL CORPORATE LAW AND FINANCE
AND FINANCIAL
MARKET AND FINANCIAL
INTERNATIONAL CORPORATE LAW AND FINANCIAL MARKET REGULATION
AND FINANCIAL
INTERNATIONAL CORPORATE LAW AND
FINANCIAL MARKET REGULATION

Perspectives in
Company Law and
Financial Regulation

**EDITED BY MICHEL TISON,
HANS DE WULF,
CHRISTOPH VAN DER ELST AND
REINHARD STEENNOT**

CAMBRIDGE

Juries and the political economy of legal origin

MARK J. ROE*

I. Introduction

Legal origin – common law versus civil law – is important to the past decade’s finance theory. Peculiarly, the theory has not had traction in the academic legal literature, which might be surprising given academic disciplines’ understandable tendency to see their own issues as central and determinative. What legal academic commentary that the theory has provoked has either been sceptical that the legal origins channels that the law and finance literature promotes are really so important or sceptical that origin could be as important as modern political economy considerations. That is, while the legal literature hardly denigrates law’s importance, it has doubted the importance of legal origin to financial development. Mahoney,¹ although sympathetic in part (particularly to the idea of a detrimental statist nature of civil law), denigrates the idea that civil law codification can be as important as the legal origin theory had hypothesized, since so much of American corporate and commercial law is codified. Coffee² sees the propensity of some countries to disrupt their stock markets, which would have provided the needed investor protections regardless of underlying legal institutions, as central. Roe indicates that while property rights and investor protection are important, legal origin differences cannot explain the institutional differences, since common law countries use non-common-law institutions, such as securities regulators, and not just common-law-oriented fiduciary duties: modern political economy forces are likely to explain modern financial and investor protection differences in wealthy nations better than legal origin.³

* This article was originally published in the *Journal of Comparative Economics*, 35 (2007), 294–308.

¹ P.G. Mahoney, ‘The common law and economic growth: Hayek might be right’, *Journal of Legal Studies*, 30 (2001), 503–25.

² J.C. Coffee, ‘The rise of dispersed ownership’, *Yale Law Journal*, 111 (2001), 1–82.

³ M.J. Roe, ‘Political preconditions to separating ownership from corporate control’, *Stanford Law Review*, 53 (2000), 539–606; M.J. Roe, ‘Legal origins, politics, and modern stock markets’, *Harvard Law Review*, 120 (2006), 460–527.

In *Legal Origin?* Klerman and Mahoney⁴ investigate central elements of Edward Glaeser and Andrei Shleifer's⁵ analysis of how differences between common and civil law emerged in the thirteenth century, critiquing a paper called, simply enough, 'Legal Origins.' There, Glaeser and Shleifer said that the English judiciary was decentralized relative to the French and that political differences between England and France at the time best explained that relative decentralization. The relative power of the king in each nation differed, the barons feared the king more than one another in one nation (and one another in the other nation), and each nation's economic structure differed, with large contiguous land holdings in France giving the thirteenth century French barons more power and autonomy than the British barons.

I had much admired Glaeser and Shleifer's investigation and explanation, because it focuses on power and politics in the thirteenth century as explaining legal structure outcomes; despite that I am not a fan of the legal origins strand in the law and finance literature overall, as the citations in the first paragraph of this note suggest. I am sceptical of their big picture story because, first, it exaggerates the impact on financial outcomes of differences in legal style, when there are much more important – and more modern – explanations for the differences than legal origin. It also privileges corporate legal institutions in finance, which while important, are usually less critical than whether the polity has an ongoing antagonism to, or affinity for, capital markets. If the polity likes capital markets, then capital markets will tend to get the supporting institutions that they need. While older legal institutions are important, they are only part of the story and probably not the central one. Equally important, the differences in institutions between the legal origins are not so wide that either one is disabled or privileged in achieving the goals sought, such as investor protection primarily and property protection more broadly. Indeed, common law countries use regulators, such as the Securities and Exchange Commission, and codes, such as the securities regulations and the uniform commercial code, to deal with commercial disputes among investors and merchants. When we use those kinds of institutions, we forgo whatever advantages common law institutions, such as fiduciary duties, could have provided. Investor

⁴ Daniel M. Klerman and Paul G. Mahoney, 'Legal Origin?', *Journal of Comparative Economics*, 35 (2007), 278–93.

⁵ E. Glaeser and A. Shleifer, 'Legal origins', *Quarterly Journal of Economics*, 117 (2002), 1193–1228.

protection can be achieved through institutions available to both legal traditions. The big picture issue is more likely to lie in whether the polity is ready to accept and promote financial markets, not which institutional forms it classically preferred.

But I admired the 2002 'Legal Origins' piece because it convincingly focused on the issues of power and politics in the thirteenth century, cogently analysing how differing political configurations in England and France then seemed to have yielded strong juries in England and centralized judging in France. I also admired the 2002 piece as a sustained effort to link legal origins institutions to outcomes in a tight way; the legal origin literature displays many regressions but few extended inquiries beyond the 2002 piece linking origins to outcomes theoretically and historically. So, it is disappointing to see that Klerman and Mahoney view the history there as not fully accurate, with the actual structures (English courts were quite centralized, they say, and under the king's thumb in the twelfth century and for centuries thereafter) the opposite of what Glaeser and Shleifer described. Since both sides rely on standard sources, perhaps there is an uncertain historical record. It is also possible that some of Glaeser and Shleifer's jury decentralization story can be preserved if we move beyond their jury story, which Klerman and Mahoney say is inaccurate, to a more general explanation for thirteenth century English decentralization. I shall explain how below.

Here I make three points about the interplay between the emergence of the jury in thirteenth century England and modern finance. The first is that legal origins proponents should have paused in their other work in which they assert that legal origin has a major impact on financial outcomes around the world, because the jury is not central to financial regulation in many important common law nations. Indeed, its existence on the periphery of finance may be detrimental to financial development. If it is the jury that needs to be explained to understand differences in legal origin, but the jury is not important to finance (or is in fact detrimental), then that suggests legal origin differences may be less important to modern finance than the origins literature has it.

Second, for the jury story to resonate with the overall legal origin story, Britain would have had to have generally transferred the jury system to its colonies. As Glaeser and Shleifer state, in the thirteenth century:

France went in the direction of adjudication by royally controlled professional judges, while England moved toward adjudication by relatively independent juries. Over the subsequent millennium, the conditions in

England and France reinforced the initial divergence in the legal systems. Moreover, the transplantation of the two legal systems ... may account for some crucial differences in social and economic outcomes in countries that are reported in empirical studies.⁶

But *did* Britain uniformly transplant the jury to its colonies? While the jury has had a long, deep and important role in the United States and Britain, it seems that most British colonies did not usually use the jury for civil trials and many, perhaps close to a majority, did not for criminal trials. The jury clashed with British colonial policy: decentralization and local empowerment was not something that the British sought, particularly after its experience with the jury in Ireland. Britain's wariness in transferring the jury around the world exemplifies a general and deeper point – it illustrates the bigger concept that legal origin institutions are trumped, and perhaps trumped easily, by modern political economy forces. Britain was in the business of running a colonial empire. If the jury conflicted with its colonial strategy, then out it went.

Third, the structure of the legal origins jury argument is in tension with the overall, bigger picture legal origins thesis. The overall legal origin thesis is that differences in French civil law and common law legal origin determine (or strongly influence) differences in modern financial markets. Why are there differences in institutions? The answer lies, the theory has it, in important part in differences in the political economies of thirteenth-century England and France: powerful barons with contiguous land holdings in France, a strong king in England. Differing legal institutions emerged then based on the differing political configurations of the time – so far, so good, those institutional differences persisted, and those persisting differences in institutions determine differences in financial markets in the twentieth and twenty-first centuries.

It is the conclusion in that chain that the legal origins' authors ought to have been more wary of: if the political economy of the thirteenth century explains thirteenth-century outcomes, why should we not look as well to twentieth-century political economy explanations to explain twentieth-century outcomes? Should we not look to historical experiences more recent than the thirteenth century as well? If political economy differences were important in the thirteenth century, might political economy differences of the twentieth century also be important, perhaps even dominant?

I explore some of these issues below.

⁶ Glaeser and Shleifer, 'Legal origins', (note 5, above), 1194.

II. Emergence of juries in the thirteenth century

A. Thirteenth-century political differences between England and France

Medieval, thirteenth-century France was unstable, while England was at peace. England's king decentralized judicial decision making, while the French king centralized it. A key piece of English decentralization was the emergence of the jury, say Glaeser and Shleifer.

According to Glaeser and Shleifer, the relative power of the king in Britain and France induced centralized French courts, because this was the only way that the relatively weak French king could control proceedings and because the rivalrous barons acceded to the king's control since they feared one another more than they feared the king. Meanwhile, the more confident English monarch in the more peaceful realm could allow for decentralized juries and courts that could counter the local barons. Glaeser and Shleifer focus in particular on bullying, with the powerful French barons more likely to bully local juries successfully than would the weaker English barons.

B. The Klerman–Mahoney reconsideration

Klerman and Mahoney say this story just was not so: British courts were, they report, centralized in the twelfth century and for centuries thereafter. Indeed, this is as one might expect (and indeed Glaeser and Shleifer expected that the powerful English king would have centralized judicial power and were surprised to conclude that he had not): the powerful monarch tries to, and succeeds in, centralizing authority, while the weaker monarch cannot. Moreover, the doctrines and institutions that emerged then that could have had later pro-investor effects seem to have emerged from the most centralized, most 'French-like' features of the English courts, say Klerman and Mahoney. If there is a true institutional difference between the common law and the civil law, say Klerman and Mahoney, it emerged centuries later.

Klerman and Mahoney point out that rather than dispersing the English judiciary, the English kings, from Henry II onward, kept the judges on a short leash. Physically the king kept them close at Westminster, that is, close to the king. Typically when they travelled through England, they did so with the king. And the English judges were a small group that the king controlled more easily than he could have controlled a larger group of judges. And, yes, the king's judges sought

to build a common law, but common in the sense of *uniform* throughout the king's lands. Moreover, they point out, doctrines and institutions like fiduciary duties – useful to modern outside investors in enterprises – emerged not in the law courts that practiced the common law, but in the king's chancery courts, which emerged in the fourteenth century as the most centralized of the English courts, the most under the king's control, and the least tied to juries. Hence, they say, whatever differences there are today between common and civil law emerged after the thirteenth century and, hence, the thirteenth-century history does not give one the opportunity to reject the basic idea that law and social/economic/political institutions are largely determined simultaneously in favour of a legal origins theory. Whatever emerged in the thirteenth century does not seem to have determined later institutions, mostly because England was centralized in the thirteenth century. Perhaps, they say, the divergence occurred later, when British merchants obtained more political power in the seventeenth century and then got the kind of court system they preferred. And, they suggest, perhaps the later, continuing divergences had much to do with the continuing ascendancy of the Whig commercial interests in England, an ascendancy that presumably allowed the Whigs to get – and keep – a legal system that was not antagonistic to their interests.

III. Legal origin theory's bigger picture

Let us take a step back from Klerman and Mahoney's critique. For the moment, let us take Glaeser and Shleifer's view of the thirteenth-century differences as accurate, despite Klerman and Mahoney's criticisms. What impact should that analysis have on the legal origins bigger picture? The jury analysis in 'Legal Origins' does not fit well with the legal origins big picture on several important margins.

First, the historical record does seem to be contestable here, since both sides use standard sources. Not being a legal historian or even someone who consults legal histories of the English thirteenth century regularly, I am not well positioned to arbitrate. Moreover, even if Glaeser and Shleifer's sources are inaccurate, perhaps enough of their basic thirteenth-century story could still be preserved to be useful. That is, Glaeser and Shleifer interpret the Magna Carta's judgment by one's peers as guaranteeing a jury trial. Klerman and Mahoney point out that the jury trial was not so used, that 'judgment' required judging not jurying. The Magna Carta did not guarantee jury trials, they argue using standard historical sources. However, the core of Glaeser and Shleifer's

specific argument here could be saved if they view the judgment of one's peers as a decentralizing move, one that reduced the king's power, even if King John never agreed to give the barons a true jury. Still, Klerman and Mahoney say that the next phrase in the Magna Carta – or the law of the land – reasserts the king's authority. Here Glaeser and Shleifer might argue that this still confined the king to avoid actions based on caprice, requiring consistency with prior rulings.

So, let us consider the implications if Glaeser and Shleifer's thirteenth-century view is, on the whole or in important part, correct. How does it fit with the bigger legal origins picture? It still fits awkwardly.

A. *What is the bigger picture?*

The bigger picture is straightforward: legal origin is important to modern finance because common law nations protect outside investors in firms better than do French civil law nations. Common law nations use fiduciary duties to protect outside investors *ex post*, after transactions occur; they also prefer transparency and property rights; and they are relatively decentralized and non-statist. The emergence of the thirteenth-century jury – in the version Glaeser and Shleifer promote – fits the bigger picture, they say, because the jury decentralizes power, reflecting and promoting the barons' independence from the English king. The less-centralized state allowed institutions that could protect property rights to emerge in a way that a centralized state might not have allowed. They state:

Starting in the twelfth and thirteenth centuries, the relatively more peaceful England developed trials by independent juries, while the less peaceful France relied on state-employed judges to resolve disputes. It may also explain many differences between common and civil law traditions with respect to both the structure of legal systems and the observed social and economic outcomes.

English systems promote commerce, French systems promote state power, and some important packet of those differences trace back to the thirteenth century.

B. *How important for modern commerce?*

One can see how the jury *could* be important to commerce. With the jury drawn from the populace, the state would find it harder to dominate decisions left to the judiciary. Judicial decentralization would facilitate

commerce. Property owners would be less fearful of state incursion. In contrast, a system of state-appointed judges operating without juries could promote state power at the expense of property interests in medieval times and business interests generally in modern times.

On the surface, there's something appealing in the idea. But some facts cause problems, problems that should induce us to rethink the idea and possibly reject it. First, the facts. The key on-the-ground American lawmaking institutions that affect outside investors are the Delaware Chancery Court and the Securities and Exchange Commission. The SEC operates without a jury, of course. It is staffed by government-appointed officials. But – and here is the problem for this arm of the legal origins theory – so does the Delaware Chancery Court. Yet the absence of the jury is regularly seen by legal commentators to be an *advantage* of the Delaware courts over others.⁷ A lively literature in legal academic circles has arisen on why American firms incorporate away from their original place of business and what the consequences of that movement are. It is quite plausible and consistent with the range of that literature that American corporations are incorporating into Delaware in part, perhaps in major part, to *escape* the jury.⁸

Moreover, English civil courts do *not* use juries, Klerman and Mahoney point out. Hence, the jury idea could have induced legal origins theorists to re-think whether the core common–civil law differences are really important to finance. If the jury is a key characteristic of the common law, but if financial interests try to *escape* the jury and often prefer (French-like) expert judges to juries, then it is open to question whether the common law generally, or this feature of traditional American and British law, is basic to finance.

C. Is the jury uniformly important in common law nations?

For the jury story to resonate with the overall legal origin story, Britain would have had to have generally transferred the jury system to its

⁷ M. Kahan and E. Kamar, 'The myth of state competition in corporate law', *Stanford Law Review*, 55 (2002), 708–709.

⁸ To be sure here, other states' corporate laws are often dealt with via jury trials and when the SEC sues wrongdoers it usually needs to operate before a jury. Trials for securities damages go to juries, but my understanding is that players consider the jury's awards to be erratic. And recall that Britain hardly uses the jury at all in non-criminal trials.

colonies. But did it? It is true that juries have had a long and storied role in English and American jurisprudence. But it appears that many, perhaps most, former British colonies do *not* use juries for civil trials and perhaps a majority do not for criminal trials. For Britain, a colonial jury clashed with British colonial policy: decentralization and local empowerment was not something that the British sought, particularly after their difficult experience with the jury in Ireland. This is not a secondary point – it fits with the bigger concept that political economy considerations trump legal origin institutions.

American colonists used the power of the jury to subvert the authority of royal governors and the Crown. Jury nullification resulted in the acquittal of John Peter Zenger (tried for criminal libel against British interests), smugglers prosecuted under the Navigation Acts, rioters against the Stamp Act, and participants in the Boston Tea Party, as Vogler retells.⁹ One royal governor complained that a ‘Customs House Officer has no chance with a jury let his cause be what it will,’ Moore reports.¹⁰ Irish juries were reluctant to enforce the law, which they saw as a tool of English domination. Their reluctance led to lower conviction rates for all crimes in Ireland than in England and Wales, Johnson states,¹¹ such that Britain suspended Irish juries during periods of unrest.¹² As a nineteenth-century colonial power, the British had reason from experience not to deeply embed the jury in its new colonies. As Young concludes, even if the French origin systems had more centralizing and less litigious potential than the British:¹³

By the time of the British imperial occupation of African territory, the dangers to colonial hegemony in indiscriminate transfer of British legal practices was well recognized. Thus, there was no question of application of the jury system of criminal law, which had so undermined the effectiveness of the law as a vehicle for colonial control in Ireland and the North American colonies.

⁹ R. Vogler, ‘The international development of the jury: The role of the British Empire’, *International Review of Penal Law*, 72 (2001), 528.

¹⁰ L.E. Moore, *The Jury: Tool of Kings, Palladium of Liberty*, (Cincinnati: W.H. Anderson Co., 1973), 110.

¹¹ D. Johnson, ‘Trial by jury in Ireland, 1860–1914’, *Journal of Legal History*, 17 (1996), 273–277.

¹² K. Quinn, ‘Jury trial in Republic of Ireland’, *International Review of Penal Law*, 72 (2001), 200.

¹³ C. Young, ‘The African colonial state and its political legacy’, in D. Rothchild and N. Chazan (eds.), *The Precarious Balance: State and Society in Africa*, (Boulder, CO: Westview Press, 1988).

The British did introduce the jury trial to India, extended it haltingly, but never fully embedded it throughout India. They used it in India to convince Europeans to feel safe working and living there, because trial by a jury (of one's European peers) protected *Europeans* from answering for crimes against Indians;¹⁴ India abolished it after independence,¹⁵ presumably because Indians saw it as a tool of hegemonic power. African encounters with the jury are parallel: Britain limited its use and, where used, used it primarily to protect Europeans against native Africans.¹⁶ This illustrates the complexity of context: the jury might well have been a *decentralizing* institution in thirteenth-century England. But, in some colonies Britain used it to *centralize* power by freeing colonizing Europeans from native justice.

To be specific here and current, several representative common law countries do not seem to systematically use juries: Botswana, Kenya, India, Nigeria, Pakistan, and South Africa. Others do, but usage is by no means uniform. Hence, if the purpose of examining the jury's emergence in England is to find a foundation for jurisprudence and decentralization in English legal origin countries, that showing has not been made. And a preliminary look at the legal history suggests it would not have been easy to find that jury foundation throughout the common law world.

D. Rebuilding Glaeser and Shleifer's jury-decentralization view

Legal origins theorists might have re-thought the jury's impact in the following way: the current *direct* presence or absence of the jury in corporate and commercial cases is not really so important (recanting some of the implications of the 2002 article), they might concede. But, overall the jury represents a decentralized system that protects property. It is an example of decentralization but not intrinsic to it.

Here is how, they might say: for governments (or the powerful, such as landowners in the thirteenth century and corporate insiders in the twentieth) to take property from another, they needed to get courts to

¹⁴ A.G.P. Pullan, 'Trial by jury in India', *Journal of Comparative Legislation and International Law*, 28 (1946), 109, 3d series.

¹⁵ Vogler, 'The international development of the jury', (note 9, above), 532.

¹⁶ R.K. Mawer, 'Juries and assessors in criminal trials in some commonwealth countries: A preliminary survey', *The International and Comparative Law Quarterly*, 10 (1961), 892-8; Vogler, 'The international development of the jury', (note 9, above), 525-52.

approve or acquiesce. But, the argument would run, if property owners are well distributed through the populace – or at least among those who could be selected for jury service – property would be protected. If the judge – appointed by the legislature, the king or those in authority – acted alone, civil-law-like, the judge might run roughshod over property rights if the judicial institution lacked a check from a property-sympathizing jury, one composed typically of property owners. Hence, the ubiquity of common law jury trials protected property, with the operational tool being that the jury would be chosen from a populace of property holders.¹⁷

Though plausible, that argument gets tied up in knots when we try to tie it to the bigger legal origin theory. What makes that kind of jury work is that property is well-enough distributed that property owners dominate juries, or the rules for jury selection make property ownership a likely characteristic of the median jury member. But the same pro-property result would be reached if property owners dominate the *legislature* (or, again, if the rules for legislative composition favoured property owners). If property owners dominate the legislature, then it will produce property-oriented legislation. It will set up rules for its courts that protect property. But if so, then the *judicial system* derives from the composition of society (or, better, from the composition of its legislative commanders). Even if the polity had *no jury*, if the *legislature* (or the electorate or the relevant decision-makers) were dominated by property owners, then that society's rules would protect property and the composition of the jury would not matter, because even if there were no jury, *judges* would have to respect property.

Hence, it is *not* whether a nation uses a jury that matters but whether the nation's *political institutions* support or denigrate property rights. If the legislature supports property and the legislature is powerful, then in the end even judges without juries will protect property. If they would not protect property, the legislature (or the executive, or the electorate) would not let them be appointed. If property-disrespecting judges did somehow get appointed, the legislature would take away their authority. Most likely, severe conflict would not arise, because judges and legislators would come from the same milieu – the same law schools, for example – and have similar world views. If property

¹⁷ Or, if they gave up their jury argument, Glaeser and Shleifer might say that the Magna Carta, by providing for judgment by one's peers, protected property owners enough in the thirteenth century that the baronial property owners would invest in improving their property.

is not well distributed among the jury population (and if the jury did thwart property rights), then the property-oriented legislature would disband or control juries (so as to protect property). Or courts would adapt to the legislative realities, in the way Spiller and Gely suggested.¹⁸ Perhaps through happenstance, this sequence occurred in the United States: a property-oriented polity allowed a corporate law institution – Delaware Chancery Court judges operating without a jury – to emerge and become important because it would protect corporate property better than a jury-based court would.

And the converse is true as well: if the legislature is antagonistic to property, then, first, the composition of the jury pool probably would not be property protecting and, second, even if it is, the rules and institutions would not last long against a property defiling but powerful legislature.

Thus, the common law jury argument standing on its own is a dead-end.

This sequence parallels Klerman and Mahoney's hypothesis that the history of British property protection emanates not from the thirteenth century jury but from the seventeenth-century legislature. Their conjecture seems plausible, because that is when commercial interests asserted themselves and came to dominate the British power structure. It also parallels¹⁹ Roe's²⁰ arguments that twentieth-century politics could have overturned prior property protection, and did in some nations. When those in power were not interested in supporting financial markets, financial markets did not develop. Nations' legal traditions were less important than their contemporaneous political economy features.

This is not just history. The process of legislative property protection is happening here and now, in the United States. Consider the *Kelo* case, which the United States Supreme Court decided in 2005.²¹ The court said that state legislatures were free to define what the public purpose was when they took property from property owners for economic development. (There is more detail here for a law school property course, but

¹⁸ P.T. Spiller and R. Gely, 'Congressional Control or Judicial Independence: The Determinants of U.S. Supreme Court Labor-Relations Decisions, 1949–1988', *RAND Journal of Economics*, 23 (1992), 463–92.

¹⁹ Roe, 'Political preconditions to separating ownership from corporate control', (note 3, above), 539–606.

²⁰ M.J. Roe, 'Delaware's competition', *Harvard Law Review*, 117 (2003), 588–646; Roe, 'Legal origins, politics, and modern stock markets', (note 3, above), 460–527.

²¹ United States Supreme Court, *Kelo v. City of New London*, 125 S. Ct. 2655 (2005).

we need not go into it.) This decision would not be a good one for a legal origin theory that sees fundamental importance in common law judicial property protection. But then the issue became a public one, going on the ballot in eleven states, with nine of them confining their decision makers from expanding the notion of property that could be taken.²² Today it is the American property-oriented polity, not the judges, that restricts takings.

IV. Juries' interaction with the bigger picture

There's another interaction between the Glaeser–Shleifer article and the bigger picture of the legal origin analysis – and it may well be more important. Let us pursue it here and see how it could lead us to higher ground and better insights. That higher ground is the ascendancy of political economy considerations in understanding the foundations for financial markets.

A. Political economy foundations in the thirteenth century

First, let us analyse the core legal origins perspective, step by step.

The central argument in this literature is that law that protects investors is important for financial markets. (Few would dispute this in its ordinary form.) Law though is not primarily the creation of modern political and economic forces, the legal origin theorists assert, but the result (primarily, largely, in important measure) of long-standing legal traditions that date back centuries. Figure 1 illustrates the view that modern property protection is rooted in medieval institutions.

What caused the common and civil law legal systems to diverge? Well, political differences in the twelfth, thirteenth, and perhaps the seventeenth centuries; political differences having to do with the relative power in England and France of the king and of the complementary relative power of the barons in each nation. I illustrate with Figure 2.

With these two sequences in mind, we can, in the legal origins theory, understand much of modern finance.

²² Castle Coalition, www.castlecoalition.org/legislation/ballot-measures/index.html (2006); C. Cooper, 'Court's eminent-domain edict is a flashpoint on state ballots', *Wall Street Journal*, August 7 (2006), A4.

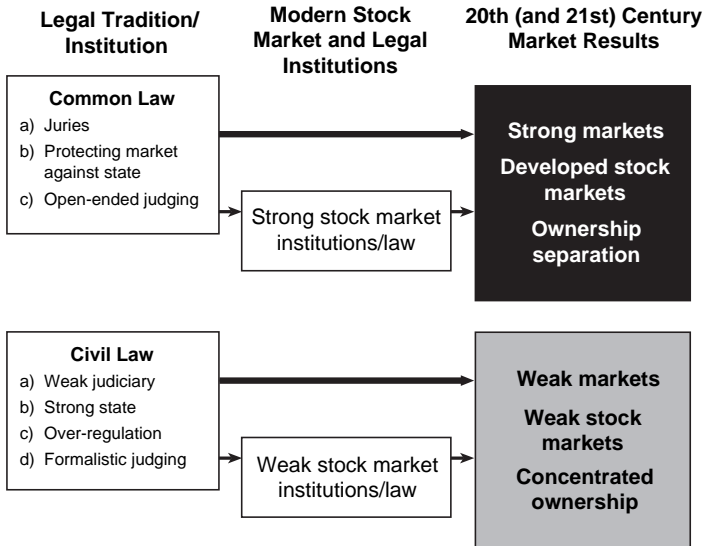


Figure 1 From medieval legal origin to modern financial markets

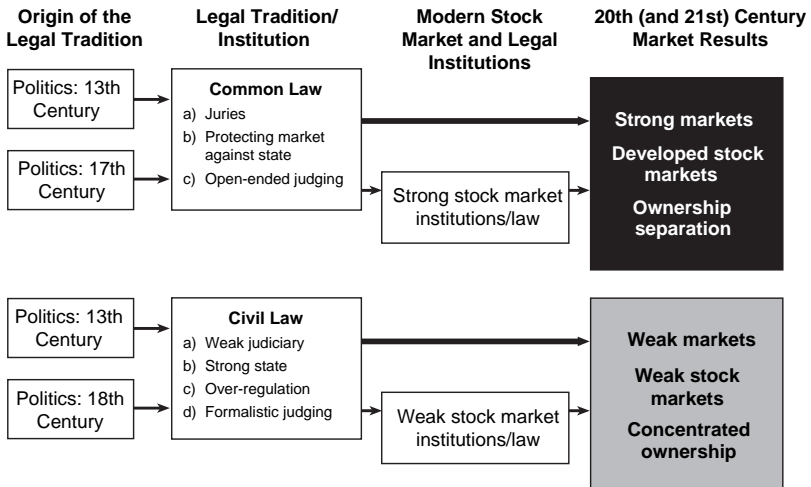


Figure 2 From medieval political foundations to legal origins differences

B. Political economy foundations in the twentieth century?

So in the legal origins theory, politics is indeed important, but its importance is in how it induced institutional differences to arise in the twelfth,

thirteenth, and maybe the seventeenth centuries. Modern politics in the theory is relatively unimportant. For example, in one legal origins piece, Botero et al.²³ argue that left–right power and the relative importance of labour interests are not as important to European labour legislation in the past few decades as legal origin. One might – dropping the theory’s transmission institution of legal origin – call the thesis one of the medieval origins of modern financial markets. I illustrate with Figure 3 the legal origin advocates’ rejection of modern politics as a key determinant of financial markets. (Surely the authors would not deny that modern politics has some effect, but their idea would be that its effect is smaller than legal origin, or interacts so closely with legal origin that it is really origin that determines the lion’s share of the political economy configurations and the financial outcomes.)

An alternative view, one that I illustrate with Figure 4, is that modern politics *is* quite important to modern financial markets. Some polities favour capital markets; others are hostile to financial markets. The first will build supporting institutions; the second will not. And even if the second does build those institutions at times – or does allow them to emerge privately – they will not do much good in developing deep financial markets because capital owners are wary of letting go of their capital in a hostile (or indifferent) political environment. Roe develops this theory.²⁴

The point here is not to deny that institutions, particularly legal institutions, are sticky. They are. And their stickiness can persist for years, even decades, impeding some changes.²⁵ But stickiness does not mean that, once constructed, they are impervious to subsequent influences. If history had ended in the thirteenth or seventeenth centuries in Europe, then it is plausible that the institutional objects, having been set in motion, would persist. And if those institutional differences were central to financial differences (a view disputed in part by Klerman and Mahoney here and Mahoney²⁶ and Roe elsewhere – because both sets of institutions can achieve the same investor protection ends if the political

²³ J. Botero, S. Djankov, R. La Porta, F. Lopez-de-Silanes and A. Shleifer, ‘The regulation of labor’, *Quarterly Journal of Economics*, 119 (2004), 1339–1382.

²⁴ Roe, ‘Political preconditions to separating ownership from corporate control’, (note 3, above), 539–606; Roe, ‘Delaware’s competition’, (note 20, above), 588–646; Roe, ‘Legal origins, politics, and modern stock markets’, (note 3, above), 460–527.

²⁵ M.J. Roe, ‘Chaos and evolution in law and economics’, *Harvard Law Review*, 109 (1996), 641–68; L.A. Bebchuk and M.J. Roe, ‘A theory of path dependence in corporate ownership and governance’, *Stanford Law Review*, 52 (1999), 127–69.

²⁶ Mahoney, ‘The common law and economic growth’, (note 1, above), 503–25.

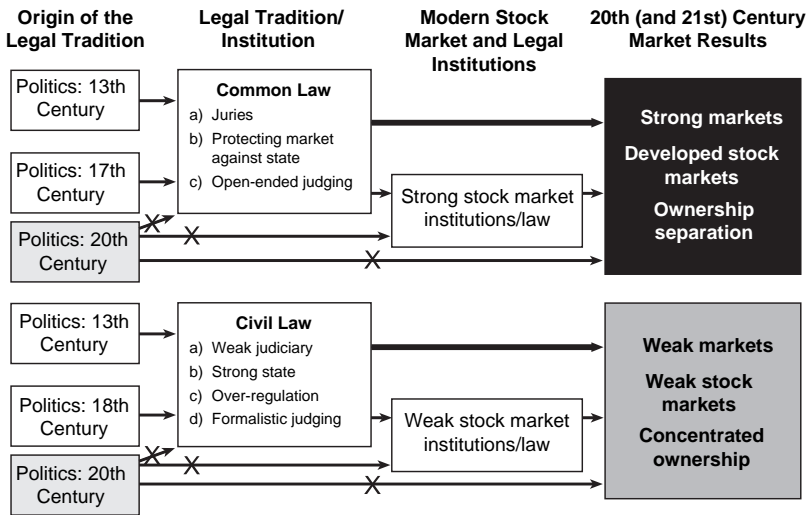


Figure 3 Medieval legal origins and the unimportance of modern politics to modern financial markets

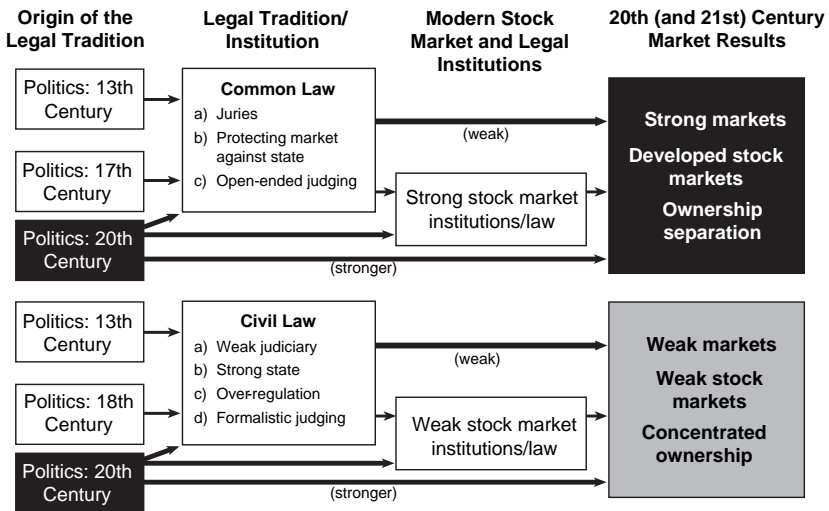


Figure 4 The importance of modern politics to modern financial markets

will is there), then modern finance could well have been determined by centuries-old institutions. More plausibly, other institutional differences arose in the interim, replacing, strengthening and changing earlier ones. The residue of events from the thirteenth century was certainly an input,

but only one and probably not the determinative one. Certainly the English Civil War and the Glorious Revolution were central to English history, substantially influenced the English economy in the seventeenth century, and had continuing influence into the eighteenth century and beyond. Certainly the welfare state's rise in the twentieth century and its intensity in continental Europe could have affected finance and property. The point is not that institutions are not sticky, but that the events that influence them occur more frequently than once every seven centuries.

C. Differences due to wars and insecurity

A parallel analysis of the legal origins argument can be made – parallel in the sense that the influence of thirteenth century (or seventeenth century) institutional differences has strong modern parallels, forcing us to wonder whether it's the medieval influence or the modern one that is the stronger one. Starting in the twelfth and thirteenth centuries, Glaeser and Shleifer state (at 1194):

France went in the direction of adjudication by royally controlled professional judges, while England moved toward adjudication by relatively independent juries. Over the subsequent millennium, the conditions in England and France reinforced the initial divergence in the legal systems. Moreover, the transplantation of the two legal systems ... may account for some crucial differences in social and economic outcomes [around the world].

Glaeser and Shleifer say that this happened because the French situation in the thirteenth century was unstable, while the English enjoyed (relative) tranquillity. This – relative order and tranquillity in England – induced differential institutional development. As Glaeser and Shleifer plausibly state (at 1208):

We estimate that between 1100 and 1800, France had a war on its soil during 22 per cent of the years, whereas England only 6 per cent (one can also argue that the wars on English soil were relatively bloodless). The constant war on the French soil meant that weapons and warriors were readily available to anyone who wanted to subvert justice.

Glaeser and Shleifer focus on the stability of the jury system:

It is not entirely surprising...that tight state control of adjudication has often been introduced as part of national liberation or unification, often in the aftermath of national liberation or civil war and other disorder.

Without internal peace to begin with, a system of juries may simply not work.²⁷

Again, the jury system might not be so central to modern finance, for the reasons I gave a few pages ago, and may not have been transplanted around the common law world, but one could stick with the basic elements of the Glaeser–Shleifer argument by substituting the consequence as being one of a decentralized state, one amenable to local, property interests (for which the jury could have been a manifestation, but not a necessary one) and which internal and external disorder would weaken.

Some of this relative order arose, I shall add to give some texture to Glaeser and Shleifer's argument, from the differences of geography: the open areas of the European continent put differing, often hostile, populations next to one another. The English had the advantage of being separated by a channel of water, with the Scots and Welsh as the only immediate hostile neighbours. (Invasions of England, like the Norman one in 1066 and what could be characterized as the Dutch one of 1688, were difficult to pull off.) The contrasting geography of the thirteenth century gave a geographic impetus to a powerful prince in Europe in general and France in particular, one who could fend off hostile neighbours. The English had an easier time thinking of suppressing a standing army and decentralizing power than would most states on the continent.

From these differences in internal and external order, in the Glaeser and Shleifer perspective, it is plausible that a centralized civil law system emerged on the continent in France, perhaps as early as the thirteenth century, and a less centralized one emerged in England. Centuries later, these contrasts affected finance, with the English courts better equipped institutionally to protect property, shareholding and creditor interests than the centralized, statist civil law systems, as Figure 5 illustrates.

But the problem is that this kind of continental European disorder did not end once and for all in the thirteenth century, or even in the seventeenth century. This contrast persisted up to 1945 and the end of World War II, or perhaps until 1989 and the collapse of traditional communism and the Berlin Wall. Figure 6 illustrates. Proponents of the legal origin story may simply be seeing in medieval legal origins the back reflections of more modern – and more important – political economy differences of the twentieth century, differences arising in large measure from the

²⁷ Glaeser and Shleifer, 'Legal origins', (note 5, above), 1211.

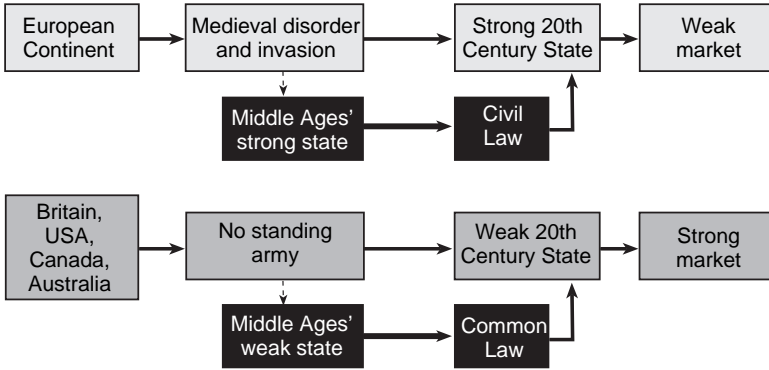


Figure 5 Medieval disorder and stability

contrasting levels of twentieth-century disorder and destruction, and their political consequences. And that, I suspect, is where, for modern financial outcomes, the real political economy story begins in earnest.

V. Conclusion

Legal origin has been brought forward as a key influence on modern finance, with the perspective being advanced that common law institutions are intrinsically better adapted to protect investors than civil law institutions. Glaeser and Shleifer offer a creative inquiry into the early emergence of the jury in common law nations and its relative unimportance in civil law nations.²⁸ They offer it as one of the significant continuing differences between common and civil law, one dependent on the differences in relative power between the English monarch and the French one in the thirteenth century, with the powerful British monarch able to forgo centralization, while the weaker French monarch needed to assert control over localities via a more powerful judiciary. Daniel Klerman and Paul Mahoney provide an excellent analysis of the difficulties of doing this kind of historical work, as it turns out that much evidence indicates that the powerful British monarch in fact centralized judicial authority.²⁹ If differences emerged, say Klerman and Mahoney, they emerged later on. Moreover, they say that one cannot yet reject the possibility that law is determined simultaneously with social, political

²⁸ Glaeser and Shleifer, 'Legal origins', (note 5, above), 1193–228.

²⁹ Klerman and Mahoney, 'Legal Origin?', (note 4, above).

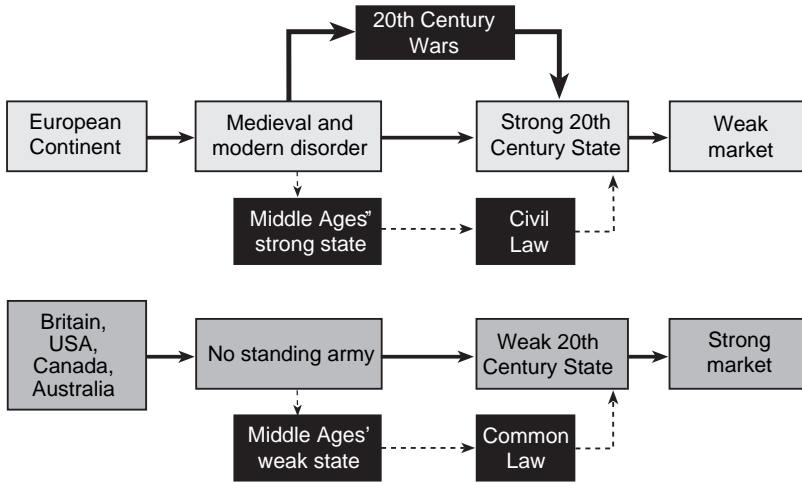


Figure 6 Modern disorder and stability

and economic facts, as the thirteenth century structures did not seem to predetermine the later ones. If by simultaneous, we mean over the course of decades, with multiple feedback effects, their thesis is one I'd sympathize with and indeed put forward.³⁰

And the basic investigation here of the jury should give pause to those promoting the overall legal origin thesis. The first reason to hesitate is that the jury is not central to protecting outside investors in common law nations. Indeed America's premier corporate court – the Delaware Chancery court – sits without a jury and the usual view in legal circles is that the jury's absence (which results in decision making by expert judges, not juries) is a strength of the court, not a weakness. The second reason is that Britain often did not transfer the jury to its colonies. The transplantation assumption in the legal origin literature is weaker, maybe much weaker, than the law and finance literature has it. The third reason is that the analysis for the jury differences between civil and common law nations depends on political economy differences of centuries ago. But if political economy differences determined institutional differences in the earlier centuries, it is plausible that political

³⁰ Roe, 'Political preconditions to separating ownership from corporate control', (note 3, above), 539–606; Roe, 'Delaware's competition', (note 20, above), 588–646; Roe, 'Legal origins, politics, and modern stock markets', (note 3, above), 460–527.

economy differences in intervening centuries *also* have affected financial outcomes. Indeed modern and contemporary political economy differences that lead some nations to support capital markets and some to denigrate them could be as important to modern financial outcomes as thirteenth and maybe even seventeenth century political differences. Perhaps more so.

