

**LEGAL ORIGIN, JURIDICAL FORM AND INDUSTRIALISATION IN  
HISTORICAL PERSPECTIVE: THE CASE OF THE EMPLOYMENT  
CONTRACT AND THE JOINT-STOCK COMPANY**

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## **Abstract**

The timing and nature of industrialization in Britain and continental Europe had significant consequences for the growth and development of labour market institutions, effects which are still felt today and which are visible in the conceptual structure of labour law and company law in different countries. However, contrary to the claims of the legal origin hypothesis, a liberal model of contract was more influential in the civilian systems of the continent than in the English common law, where the consequences of early industrialization included the lingering influence of master-servant legislation and the weak institutionalization of the juridical form of the contract of employment. Claims for a strong-form legal origin effect, which is time invariant and resistant to pressures for legal convergence, are not borne out by a growing body of historical evidence and time-series data. The idea that legal cultures can influence the long-run path of economic development is worthy of closer empirical investigation but it is premature to use legal origin theory as a basis for policy initiatives.

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## 1. Introduction

A central claim of contemporary economic theory is that institutions, understood as rules, practices and routines of varying degrees of formality and embeddedness, matter to economic performance (North, 1990; Aoki, 2001). A branch of new institutional economics, the legal origin hypothesis, suggests that legal rules affect economic growth according to how far they support the formation of markets and the protection of property rights, particularly in the context of the rules governing the business enterprise (Glaeser and Shleifer, 2002). The content of legal rules is in part a function, it is argued, of the infrastructure of the legal system, including the way that disputes are resolved, the relationship between the courts and the legislature, and the capacity of legal rules for adaptation. The nature of this legal infrastructure varies across national systems, with a principal point of difference being the divide between the common law and civil law legal families (Djankov *et al.*, 2003). It is claimed that thanks to deep rooted path dependencies, systems which have a common law origin enjoy a comparative advantage over their civil law counterparts, at least in a period, such as the present, when growth is linked to processes of market liberalization to which common law institutions are, seemingly, well suited (La Porta *et al.*, 2007). Empirical support for this claim derives from the analysis of indices which measure differences in the content of legal norms at cross-national level. Once legal variation is quantified in this way, it becomes possible to examine links between legal norms and economic performance. Common law systems, on the whole, appear to have superior economic growth, at least in relation to French-origin systems (Mahoney, 2001; La Porta *et al.*, 2007).

The legal origin hypothesis is one of the most significant ideas to have emerged in the social sciences in the past decade and it is also one of the most influential. The *Doing Business* reports of the World Bank, which incorporate the legal origin approach and methodology, rank countries according to how well their legal environment supports enterprise (World Bank, various years). The rankings, it is said, have ‘encouraged regulatory reforms in dozens of countries’ (La Porta *et al.*, 2007, p. 325). The current prominence of the legal origin claim has not, however, settled the debate over its validity. On the contrary: both the theory underlying the claim, and the empirical methods used to support it, are contentious. In this paper, one particular aspect of the claim will be examined, namely the existence of a link between long-run trends in the legal-institutional framework and economic development.

It has been said, perhaps with only a little exaggeration, that the British industrial revolution is ‘the centrepiece of world history over recent centuries, and *a fortiori* of the country in which it began’ (Wrigley, 1988, p. 8). As such it

seems an appropriate case for an examination of the legal origin hypothesis. Among the relevant questions are: what do we know of the relationship between legal change and industrialization in Britain? How does that process compare to changes going on in other systems in Europe at the same time? What is the legacy of the institutional developments which took root at this point and how far have they influenced the subsequent trajectory of both the ‘parent systems’ – that is, those in which the distinctive legal infrastructures of the common law and civil law first originated – and the ‘transplant systems’ – those to which these infrastructures were diffused or upon which they were imposed by conquest or colonization?

These are big questions, but questions, nevertheless, which the legal origin hypothesis poses in a particularly sharp way, and to which it is necessary to respond if that hypothesis is to be effectively evaluated. A start will be made in that process here by looking at some of the available evidence on the evolution of two of the basic legal forms of modern industrial economies: the contract of employment and the joint stock company. When did these forms emerge and what is the relationship of their evolution to the nature of industrialization in different countries? It will be argued that significant inter-country differences in the path of industrial development in parent systems were reflected in variations in these legal forms. When they were diffused through legal transplantation, they carried with them distinctive approaches to the governance of the firm. However, the differences in question do not map on the supposed divide between a ‘market-orientated’ common law and a ‘regulation-orientated’ civil law. Divergence had more fundamental causes: principally, differences in the timing of industrialization in relation to institutional change. Essentially, industrialization preceded legal change in Britain, whereas this relationship was reversed in France and Germany. In these systems, the institutional revolution which came about with the adoption of the first private law codes occurred several decades in advance of comparatively late industrialisation. This differential ‘sequencing’ of legal and economic change is a more powerful explanatory variable than common law or civil law legal origin as such; although since legal systems reflect and to some degree perpetuate differences in the structure of the business enterprise across national systems, legal infrastructure is one among a number of factors contributing to the ‘varieties of capitalism’ today.

Section 2 below sets out the basic claims of the legal origin school and summarises the main lines of the debates concerning their theoretical and empirical validity. Section 3 overviews evidence on how legal innovation in ‘parent systems’ (Britain, France and Germany) was linked to the process of industrialization and considers evidence on the transplantation of norms.

Section 4 assesses the legacy of legal origin on contemporary labour and company law. Section 5 concludes.

## **2. Legal form, economic function and cross-national variation in the law of the business enterprise**

According to the Coasean tradition within new institutional economics, the identifying feature of the firm is that the price mechanism is displaced by centralized coordination by a manager or entrepreneur; likewise, ‘it is the fact of direction which is the essence of the legal concept of “employer” and “employee”, an observation which leads Coase to conclude that his economic model ‘is one which closely approximates the firm as it is considered in the real world’ (1988, p. 54). In the same vein, Hansmann and Kraakman (2004, p. 2) claim that the concepts associated with the company limited by share capital, including limited liability for shareholders and separate corporate personality, are ‘induced by the economic exigencies of the large modern business enterprise’, so that ‘corporate law everywhere must, of necessity, provide for them’. The implication is that the employment contract and the corporation are universally functional forms which are to be found wherever the business enterprise exists. They were called into being by the emergence of the modern firm and they now underpin its operation by minimizing the transaction costs of production and exchange within that particular setting.

The legal origin approach does not contradict the idea that legal rules have some degree of functionality with regard to the economy. Indeed, ‘law matters’, or is said to matter, to economic growth in various ways. One of the most important is the extent to which the law protects the interests of shareholders against expropriation by management in the context of the joint stock company. A regime of effective investor protection is said to be one in which firms can more readily raise external finance (La Porta *et al.*, 1998). The growth of private credit in systems is said, likewise, to be enhanced by laws which protect creditor interests in the event of the firm’s insolvency (Djankov *et al.*, 2007). In so far as the external financing of firms, through the capital markets or through the credit system, is understood to be a factor in promoting economic development, legal protection for shareholders and creditors can be said to promote growth (Levine, 2005). In the case of both equity-based and debt-based financing, the law serves to reduce agency and other transaction costs associated with the financing of the firm, enables investors to diversify their risk, and more generally contributes to liquidity within financial markets (Easterbrook and Fischel, 1990). Labour regulation, on the other hand, is seen as largely driven by non-efficiency considerations, and through its encouragement to rent-seeking, has the potential to depress growth (Botero *et*

*al.*, 2004). It is assumed here that the basic economic model of the employment contract, in which powers of direction are reserved to the employer and a competitive labour market ensures an equilibrium between supply and demand, is an efficient one, which regulatory intervention will mostly likely undermine.

Where the legal origin approach departs from prior accounts of the role of the law is in pointing to significant cross-national differences which, it is argued, are reflected in economic outcomes. It is a striking feature of the legal origin literature, sometimes called in this context the ‘new comparative economics’ (Djankov *et al.*, 2003a), that significant variations across national regimes have been found in all the areas of law which have been examined using this methodology, and that these differences map on to the divide between common law and civil law legal families. The first finding of the legal origin school and perhaps still the most influential was to the effect that systems of common law origin provide higher levels of investor protection than those of the civil law (La Porta *et al.*, 1998). The study supporting this claim was based on the construction of an ‘anti-director rights index’ which measured shareholder protection according to six variables: ‘proxy by mail allowed’, ‘shares not blocked before the meeting’, ‘cumulative voting’, ‘oppressed minorities mechanism’, ‘pre-emptive rights to new issues’, and ‘share capital required to call an extraordinary shareholder meeting’. To these were added a number of other relevant variables including ‘one share one vote’ and ‘mandatory dividend’. A ‘creditor rights index’ was also developed in this paper, based on the variables ‘restrictions for going into reorganisation’, ‘no automatic stay on secured assets’, ‘secured creditors first’ and ‘management does not stay’. In most cases, the laws of the countries concerned (49 in this particular study) were coded using binary values, with ‘1’ indicating protection and ‘0’ no protection. The legal rules examined were those in force in the mid-1990s. When the results were regressed against a number of legal and economic indicators, it was found that common law systems (essentially those of the USA and Britain and its former colonies) provided significantly higher levels of shareholder and creditor protection than civilian ones. French civil law systems (the systems of France, the low countries, Spain, Italy, Latin America and parts of Africa and east Asia) scored the lowest, with German origin systems (most countries in central and eastern Europe, some former German colonies, and most of east Asia including Japan, Korea, China and Taiwan) and Nordic systems in the middle. Low levels of shareholder protection were associated with high levels of concentration of share ownership in large publicly listed companies, in particular in French-origin systems. Thus differences across legal systems really did matter: ‘legal systems matter to corporate governance and ... firms have to adapt to the limitations of the legal systems that they operate in’ (La Porta *et al.*, 1998, p. 1117).

The codings in the early legal origin papers were criticized for their inaccuracy (some of the judgements made behind the ascription of particular scores to variables were open into question: Cools, 2005; Braendle, 2005; Spamann, 2005), inconsistency (by attributing equal weight to the individual variables the index introduced implicit weightings which had not been clearly justified: Aherling and Deakin, 2007), and selection bias (the variables chosen reflected certain features of developed economies, in particular that of the USA, which were not universally relevant: Siems, 2005). When the original ‘law and finance’ index was reconstructed using more a more consistent approach to coding, many of the original results disappeared (Spamann, 2005). These criticisms prompted legal origin theorists to develop a number of alternative approaches to the quantification of legal rules, the analysis of which restored their core results. Thus a ‘self-dealing index’ which relied upon responses from law firms for to a question about the law would be applied to a case of a conflict of interest on the part of a director or senior manager, reproduced the finding that common law systems were most protective of shareholder rights (Djankov *et al.*, 2008). Studies extending the original creditor rights index confirmed the view that strong protection for creditors in insolvency law and the law of secured transactions increased levels of private credit in economies (Djankov *et al.*, 2006, 2007).

The labour regulation index, which appeared in the early 2000s, contained over one hundred variables, divided into three main areas: employment law, industrial relations law, and social security law (Botero *et al.*, 2004). These three sub-indices were further divided; in the case of the employment law sub-index the relevant variables were ‘[availability of] alternative employment contracts’, ‘cost of increasing hours worked’, ‘costs of firing workers’ and ‘dismissal procedures’. Each of these composite variables contained several individual indicators. Again, analysis demonstrated cross-national variation by reference to the origin of legal systems: the intensity of labour regulation was greater in civil law systems, with the French-origin systems displaying the highest scores. Higher levels of regulation were found to correlate with lower male labour force participation, higher youth unemployment, and a larger informal economy. Thus the authors concluded against the view that labour regulation could be explained on efficiency grounds: ‘legal origins shape regulatory styles, and... such dependence has adverse consequences for at least some measures of efficiency’ (Botero *et al.*, 2004, p. 1378).

These findings, based as they were on a novel empirical approach to analyzing the impact of legal rules, were nevertheless in need of a theoretical explanation. Two complementary ones were provided (Beck *et al.*, 2003). According to the first of these, legal infrastructure influences the content of legal norms, and

thereby economic outcomes, via an ‘adaptability channel’. The common law is founded on judge-made rules which emerge from the mass of individual legal precedents in a case-law based system. As such, common law rules form a kind of emergent or spontaneous order which responds to shifts in economic conditions over time. This idea is a development of a claim previously made in the economic analysis of law, to the effect that the common law evolves in a way which selects against inefficient rules. Rules which destroy private wealth are more likely to be litigated against than those which support wealth-creation. In this way, the system contains an inherent disposition to discard market-unfriendly rules, or to adapt them in favour of market-friendly ones (Priest, 1977). The civil law, which does not recognize judicial decisions as precedents to the same degree as the common law, and which views legal codes as primary sources of law, has no such mechanism (or so it is said). The second explanation is based on public choice theory and posits the existence of a ‘political channel’. Common law systems, because of their support for judicial independence and the power of the courts to control the exercise of executive power, provide fewer opportunities for rent-seeking than systems of the civil law which look to legislation and codification to provide legal solutions, and thereby avoid disruptive distributional conflicts.

These perspectives found support in the further development of the empirical branch of the legal origins literature. A ‘legal formalism index’ was developed which focused on differences in court procedure across systems (Djankov *et al.*, 2003b). The information on which the index was based was drawn from questionnaires sent to international law firms. They were asked to assess how long it would take to enforce two types of basic legal claim: recovering on a bounced cheque, and evicting a tenant who owed rent. The expense and time devoted to pursuing these claims was found to be significantly greater in French civil law systems than in those of the other legal families. This was taken as confirmation of the idea that the civil law (above all in its French-origin variant) was less amenable to the enforcement of basic property and contract rights than the common law.

Notwithstanding this apparent empirical validation, there are problems with the suggested ‘channels’ linking legal infrastructure to substantives rules and then to economic outcomes. The idea of legal families is an abstraction which glosses over the empirical detail of legal systems; because of the interchanges between systems which have taken place over time, and their many common conceptual reference points, most national regimes have a ‘mixed’ or ‘hybrid’ aspect to them (Siems, 2005). If the notion of families of systems is not entirely artificial, modern comparative law studies nevertheless take the view that the association of the common law systems with judge-made law, and the

civil law systems with regulation, masks a more layered reality (Mattei, 1997; Markesinis, 2003; Glenn, 2007). As we shall see in more detail in section 3 below, within common law systems, many of the rules relating to the business enterprise and to the employment relationship are statutory in origin. Legislation was needed to introduce the institutions of limited liability of shareholders and separate corporate personality in both Britain; the common law (in the sense of the judge-made rules of private law) resisted both ideas (Harris, 2000). Similarly, the law governing the employment relationship in Britain during the industrial revolution was a mixture of statute (master-servant legislation) and the common law of contract; the role of legislation was significant at all stages (Deakin and Wilkinson, 2005). Today, the scale and complexity of both labour and company legislation in the UK is such that commentators have observed that its excessive length makes it cumbersome and rigid by comparison to the civil law approach of continental European systems (Davies, 1997, p. 8). When we turn to the civil law, we find, conversely, that alongside what is clearly a considerable body of legislation governing commercial and private law relationships, there has long been a prominent role for the courts in legal innovation (Pistor, 2005). It was judges interpreting the civil code in an unexpected way who, for example, developed the concept of good faith in commercial contracts in Germany (see Teubner, 2001). The private law codes of the civilian world, far from being rigid and monolithic statutes, are (at least in their nineteenth century core) restatements of principle, which have been open to reinterpretation by the courts, with the result that their meaning has been substantially reshaped over time.

A closer look at legal systems, informed by comparative law theory, therefore suggests that there is no reason to believe, *a priori*, that the basic infrastructure of common law systems is inherently more adaptable, or less prone to rent-seeking, than that of civil law systems. All systems are hybrids in which legislation and case law both play a role in shaping the content of legal rules. The question of how far they balance the tension between continuity and flexibility in the formation of substantive rules, and of to what extent they are vulnerable to self-seeking interest groups, are empirical ones, which should be investigated by identifying specific institutional mechanisms which might have these effects (Siems, 2006).

This is not the same thing as saying that the common law/civil law divide is of no significance. Where modern comparative legal studies and the ‘new comparative economics’ find some common ground is in the concept of ‘legal cultures’ which have the potential to shape approaches to regulation. The idea of legal culture refers to ingrained practices operating to a certain extent beyond the scope of formal norms, which inform approaches to the making,

interpretation and application of rules (Legrand, 1997). A relevant illustration of this in the present context is the tendency of civil law regimes to place greater weight on mandatory rules of law in the governance of business relationships, in contrast to a common law view which gives priority to the parties' agreement and sees compulsory norms, whether deriving from statute or from the judge-made law, as exceptional (Pistor, 2005; Deakin, Lele and Siems, 2007). The civilian view is the product of a certain way of conceptualizing the relationship between the legal system and private contract; contracts are made within a framework set by the private law codes and as such are subject to certain principles of the law which can have overriding effect. This orientation has been interpreted by legal origin theorists as an anti-market view: 'when the market system gets into trouble or into a crisis, the civil law approach is to repress it or even to replace it with state mandates, while the common law approach is to shore it up' (La Porta *et al.*, 2007, p. 308). A different perspective is that the civilian approach does not 'restrict' markets as such, but rather sees a role for the legal system as constituting the conditions under which market relations are formed. In viewing civil law rules as an instance of external regulation of otherwise autonomous contractual agreements, the legal origin hypothesis would then be in danger of according universal validity to what is, in essence, a perspective specific to the common law (Deakin, 2006).

Be that as it may be, now that legal origin theorists have accepted the relevance of legal culture to their work (La Porta *et al.*, 2007, p. 311), there is the opportunity for a deeper empirical investigation of this phenomenon and its role as a source of cross-national diversity. However, there is a need to move beyond the methods so far relied on to provide empirical support for the legal origin claim. The main drawback of the existing studies is that they rely on cross-sectional data on the state of the law, in a period, sometimes quite loosely defined, from the mid-1990s to the early 2000s. Several studies have queried the assumption of a time-invariant legal origin effect. It is hard to make out a consistent and continuous influence of legal origin given the 'great reversals' in the development of stock markets which have taken place in the course of the twentieth century (Rajan and Zingales, 2003); the external shocks of depression and war have been powerful influences on financial development (Roe, 2006).

The claim that common law systems enjoy higher levels of GDP growth than civil law systems (Mahoney, 2001), or at least the French-origin ones (and even here the effect is weak once certain controls are taken into account: La Porta *et al.*, 2007) is also affected by the issue of time invariance. The result is sensitive to the period in question being studied and to the choice of countries in the sample. Between the 1950s and the late 1970s so-called 'coordinated market' systems, all of which are civilian in origin, grew faster than 'liberal market'

ones, all of which are common law in origin, if only developed countries are taken into account. The picture is reversed for the period since the early 1980s (Hall and Soskice, 2001). None of this suggests, in itself, that the legal origin was the cause of the differential growth rates in either period; it does however imply that if there is such an effect, it is not constant.

If the legal origin hypothesis were correct, we would expect to see stable differences across national systems over time, and these differences being reflected in differences in GDP growth. Until recently no systematic evidence was available on this question, but now that systematic longitudinal data are available, it is clear that even going back only a few decades, the laws governing the enterprise have been subject to considerable change within national systems, that the rank order of countries has changed, and that the relative position of common law and civil law groupings was not always as it seems to have been in the late 1990s (Siems, 2008; Lele and Siems, 2007; Deakin, Lele and Siems, 2007; Armour *et al.*, 2007, 2008; see further section 4, below). Perhaps the best thing that can be said of the claim that legal origin is linked to GDP growth is that it is yet to be clearly established, given the present limited state of data on legal change.

It is not just longitudinal data on legal change that have, until very recently, been lacking; a more general historical perspective on the issues raised by legal origin theory is needed. It is time to consider what history might be able to tell us about legal change and economic growth.

### **3. Industrialization and legal change: the emergence of the employment contract and the joint-stock company**

#### **3.1 The experience of parent systems**

The bringing into being of modern systems of private and commercial law was one of the great institutional revolutions of the nineteenth century, a process which occurred alongside industrialization and the rise of the market economy. Labour relationships were not unaffected by this process, but in their case the new priority accorded to property and contract was qualified by a continuing role for status-based forms of regulation. Moreover, contrary to what might be inferred from the legal origin hypothesis, it was the civilian systems – both the systems of origin, and their continental European neighbours – which moved most quickly and decisively in the direction of liberalizing the law, at least at the level of formal legal rules and concepts.

### 3.1.1 The employment contract

In France, legislation of the revolutionary period brought about a fundamental break with early modern economic institutions; guilds and their equivalents were peremptorily ‘abolished’ by the décret d’Allarde and loi Le Chapelier of 1791, with the latter also making workers’ combinations and strikes illegal. The Civil Code of 1804 then classified the work relationship as contractual in nature, placing it, moreover, in the category of the ‘law of things’. This was done in order to give expression to the idea that the labour contract, just like sale or lease, was a relationship of exchange between juridical equals. All other continental codes subsequently followed this pattern: labour, or in some versions labour power – as, for example, in the German term *Arbeitskraft* – became a commodity, which was linked to the market mechanism via contract (on the pre-marxian origins of the term *Arbeitskraft* see Biernacki, 1995, and on its legal significance, see Simitis, 2000).

By contrast, Blackstone’s canonical treatment, in the mid-eighteenth century, of the relation of ‘master and servant’ in English law, had placed it firmly in the ‘law of persons’. Blackstone’s analysis was, it has been suggested, anachronistic even for its time (Kahn-Freund, 1978), but this view overstates the degree to which contractual concepts were being used to describe work relations in the period of the industrial revolution. Legislation underpinning the rights and privileges of the guilds in England, which had been in decline since the early eighteenth century, was repealed in 1813, and wage-fixing powers were removed in 1814; but master-servant legislation, which criminalized breach of the service contract and gave the magistrates powers to imprison workers for, among other things, acts of disobedience and quitting before the end of the agreed term, was retained long after that. The sanction of imprisonment was removed in the 1860s before the master-servant laws were completely repealed only in 1875. Even after this point, local magistrates retained a quasi-penal jurisdiction to order damages which were in the nature of fines against workers found to have acted in breach of contract. Thus for most of the nineteenth century, work relations in the case of manual industrial and agricultural workers (clerical, managerial and professional workers were outside the master-servant regime) were governed by a legal regime which was only partially contractual; legislation specific to master-servant relationship supported a hierarchical conception of managerial control, backed up by the criminal law, the application of which depended on the legal status of the worker (see Deakin and Wilkinson, 2005: ch. 2).

By contrast, the French Civil Code was consciously drafted in an attempt to escape from what were seen as pre-modern notions of status. The 1804 Code adopted two models of the labour contract. One, the *louage d’ouvrage* or hire of work, was modelled on the Roman law concept of the *locatio conductio operis*,

which referred to a contract for a finished job of work or completed task. The second, the *louage de services*, bore a resemblance to the Roman law *locatio conductio operarum*, or hire of services. However, these terms were adaptations which were ‘the same as the old *locatio conductio* in name only’ (Veneziani, 1986, p. 32). The Roman law *locatio* was viewed as a form implying the subordination of the worker, a concept regarded as incompatible with liberal contractual ideas. Even in the case of the *louage de services*, the form which superficially bore the closest resemblance to an open-ended agreement to serve, services could only be provided for a certain purpose or for a limited period of time.

The concept of the worker’s subordination to the employer did not, however, disappear from the law (see Veneziani, 1986). The French Civil Code itself retained the rule which stipulated that, in the event of a dispute over wages between employer and worker, only the word of the employer was to be believed. This provision found its way into the other continental codes and stayed there for the remainder of the nineteenth century. Continental systems also preserved and in certain respects strengthened the punitive, pre-modern system of the workbook or *livret*. In the same way as master-servant laws, this gave state authorities powers to regulate labour mobility and punish breaches of discipline through the use of criminal sanctions. The distinction between the *louage d’ouvrage* and the *louage de services* should be understood in this context. Workers in both categories might come under the regulatory jurisdiction associated with the *livret*, which, just before the adoption of the Civil Code, was strengthened by legislation (the law of 12 germinal An 11 (12 April 1803)). Thus the emerging forms of wage labour, rather than being confined to the superficially employment-like *louage de services*, were to be found in both categories, and in each case were subject to disciplinary legal control (Petit and Sauze, 2006).

The German Civil Code, the BGB, adopted in 1896, adopted a superficially similar terminology to that of its French predecessor. The BGB formally distinguished between the *Dienstvertrag*, literally the ‘contract for service’, and the *Werkvertrag*, the contract for work or sub-contract. However, the BGB marked a break of a different kind with the Roman law model of the *location*; the *Dienstvertrag* was placed was aligned to the law of persons, while the *Werkvertrag* was viewed more straightforwardly as a commercial relationship. The *Dienstvertrag* came to embody the idea of the employer’s duty of care (*Fürsorgepflicht*), as a counterpart to the duty of loyalty (*Treuepflicht*) owed by the worker. This was a reflection of a view among certain jurists, led by Gierke, who argued that the BGB should reflect communitarian principles which, they argued, were present in juridical forms of the work relationship which preceded

the codification process (Veneziani, 1986, p. 59; Supiot, 1994, p. 18; Sims, 2002, pp. 85-86).

None of the legal forms so far discussed completely resembles the modern contract of employment. This concept has, today, several distinct features (Davidov, 2006). Firstly, it embraces as a category all or almost all wage-dependent or salary-dependent workers, thereby overcoming old distinctions between white-collar and blue-collar workers, managerial and industrial workers, and so on. Secondly, it is distinguished from self-employment or, as it known in common law jurisdictions, the ‘contract for services’ (although with increasing uncertainty about its application to so-called flexible or marginal forms of employment such as casual work, agency work and labour only sub-contracting). Thirdly, it gives rise to a set of mutual obligations, involving a duty of obedience and cooperation on the part of the employee and a duty of care on the part of the employer. The precise scope of these obligations varies from one context to another and, in different jurisdictions, the degree to which they are regarded as open to renegotiation by the parties also differs; however, most systems agree that if these elements are altogether lacking from a given work relationship, it will not be regarded as one of employment.

This is the model described by Coase (1988) as referring to the ‘reality’ of employment and which he cited in support of his economic theory of the firm. At the time ‘The Nature of the Firm’ was written (the mid-1930s) it was both a recognizable legal model and one which corresponded well to predominant types of industrial organization. However, it was not a form which came straightforwardly into existence either at the point when industrial production began to be widespread, nor when the civil codes displaced pre-modern juridical categories. For most of the nineteenth century, work relations in industrializing countries were described by a multiplicity of legal forms, some referring to specific work categories within or beyond the category of wage labour, and in which elements of status and contract were intermingled. Different elements of these legal types eventually coalesced to form what became the ‘contract of employment’, but they did so in ways which reflected distinct legal traditions and different economic conditions across national systems.

The term *contrat de travail* (the equivalent of ‘contract of employment’) first began to be used in France in the 1880s, and as such was distinct from the versions of the *locatio* which had appeared in the Civil Code of 1804 (Cottereau, 2000). Its adoption was triggered, firstly, by the view of certain employers that a general duty of obedience should be read into all industrial hirings. The pre-existing legal forms, with their emphasis on the contractual equality of the parties, were seen as giving insufficient legal support to managerial authority within the

firm. At the same time, the new concept proved to be useful for determining the scope of industrial accidents legislation which was being adopted in that period, and it was adopted by commissions of jurists who were charged with developing a conceptual framework for the emerging law of collective bargaining and worker protection (Veneziani, 1986; Didry, 2002). This was also the point at which legislation on the *livret* was modified so that the punitive elements of the jurisdiction fell away, leaving an obligation on the part of the employer simply to record the express terms of the contract. The essence of the new model was an adaptation of the notion of ‘subordination’: an open-ended duty of obedience was read into all employment relationships, in return for the absorption by the enterprise and, via social security, the state, of social risks, beginning with health and safety and later extending to income and job security.

Legal developments in several countries around the turn of the twentieth century illustrate the growing influence of this model. The concept appears in a Belgian law of 1900, the Dutch law of the employment contract of 1907, in an Italian draft statute of 1902 and laws of 1907 and 1924, in the French *Code du travail* of 1910, in the revisions to the German code of 1913 and 1919, and in the report of a Danish commission of 1910 and a law of 1921 (Veneziani, 1986, p. 68). The logic of these innovations was not the same in every case, even if they shared an underlying continuity. In particular, there were divergences between French-origin and German-origin systems. In systems coming under French influence, the law assumed that the state had the power to regulate basic conditions of work. The idea of *ordre public social* signified a set of mandatory conditions written into the employment relationship. The law, in recognizing the employer’s unilateral powers of direction and control within the organisational structure of the enterprise, also undertook the responsibility for protecting the individual worker; the employee was thereby placed in a position of ‘juridical subordination’. In systems influenced by the German code, the contractual character of the employment relationship was qualified by a ‘communitarian’ conception of the enterprise. The German law concept of the ‘personal subordination’ of the worker implied their ‘factual adhesion to the enterprise’ (*Tatbestand*), a process conferring upon the individual ‘a status equivalent to membership of a community’ (Supiot, 1994, p. 18).

The British experience was different. The abolition of legislative support for the guilds was viewed as a necessary step in the formation of a market for labour. However, it did not lead to the adoption by the courts of the contract of employment as the paradigm legal form of the work relationship. If there was a ‘contract of employment’ in the mid-nineteenth century, it described the situation of occupational groups, such as managers, lawyers and clerks, with a high-level status or professional background, a stable relationship with their employer, and a

degree of protection against interruptions to income by virtue of sickness on the one hand and temporary fluctuations in demand on the other. By contrast, manual workers in both industry and agriculture, a category which included skilled artisans, were still covered by the Master and Servant Acts. It took the repeal of that legislation for the conceptual shift to the employment contract to begin, although the same status-based distinctions were carried over into early workmen's compensation and social insurance legislation (Deakin and Wilkinson, 2005, ch. 2).

In modern British labour law, the category of the contract of employment has expanded to cover almost all wage-dependent workers, with the category of the 'contract for services' describing independent contractors and the self-employed. However, this 'binary divide' entered British labour law at a late stage, in the 1950s and 1960s. (Freedland, 2003, chs. 1 and 2). The post-1945 welfare state saw the completion of a system of state-run social insurance which was intended to be 'comprehensive' in the sense of protecting against a wide-range of work-related risks, and the introduction of employment protection legislation stabilising the individual work relationship; it was in the context of this legislation that the courts began to apply the model of the contract of employment as a unitary category covering all forms of wage-dependent labour. The labour law model of the contract of employment was borrowed from concepts which had developed in fiscal law and social security law in the inter-war period (Deakin and Wilkinson, 2005, ch. 2).

Thus the British case is one in which the employment model emerged at a late stage in the process of legal development accompanying industrialisation, and even then was only weakly institutionalized. The French and German experiences illustrate different trajectories within which there was a more explicit recognition of the role of the contract of employment as a mechanism of integration within the enterprise and of social cohesion beyond it. The result was, viewed historically, a more complete institutionalization of the employment model at the juridical level.

A similar divergence between the British and continental experiences can be observed in company law. Britain's early industrialization came at a point when the legal institutions which later came to underpin the industrial enterprise were still in the process of formation. Not only was there no unitary model of the contract of employment at this point; limited liability was not generally available and few manufacturing firms were legally incorporated. Joint stock existed in the case of the trading companies incorporated by royal charter, and a form of separate corporate personality was available to banks and utilities such as railway and canal companies. However, joint stock did not always imply

limited liability. In the same way that the attributes of the employment contract emerged independently of each other, in different contexts and at different times, features of the corporate form which today make up a unified legal structure originated in a range of different organisational contexts (Harris, 2000). Even when a general incorporation procedure for joint stock companies was introduced by statute in 1844, followed by limited liability for shareholders in legislation of 1855-6, manufacturing firms were slow to take it up. Most of them remained sole proprietorships or partnerships until the late nineteenth century and only adopted corporate form when a merger wave began in the 1890s (Hannah, 1974)

### **3.1.2 The joint-stock company**

Company law and the work of the law relationship displayed complementary features which matched the predominant type of industrial enterprise in particular countries. Integrated managerial structures were slow to develop in most British manufacturing firms in the nineteenth century. In their place, employers relied on the disciplinary power of the master-servant regime and its post-1875 successors as a mechanism of labour control. As master-servant law faded, they made use of the 'internal contracting' system, which persisted well into the final decades of the nineteenth century and in some cases the early parts of the twentieth, to delegate the managerial function and devolve risk on to labour-only subcontractors and other intermediaries (Littler, 1982; Holbrook-Jones, 1982). Thus the slow development of the employment contract in British labour law matched a tendency for industrial enterprises to be vertically disintegrated and slow to develop a managerial specialization (Deakin and Wilkinson, 2005, ch. 2). How far this also a function of them being weakly capitalized is less clear, but where integrated organizational structures and stable, long-term employment were in evidence, it was in sectors such as the railways and utilities in which were among the first to make use of the corporate form (they had this option from an early point, subject to legislative approval of the purposes of the company) and obtained access to external finance through a broad shareholder base (Kostal, 1994).

By contrast, in the continental systems at the start of the twentieth century 'it... became common knowledge that major industrial concentration required a form of employment which had to be subordinate (i.e. completely subject to the power of the employer) in order to favour the accumulation of capital' (Veneziani, 1986, p. 71). The continent's late industrialisation occurred after the decisive break occasioned by the codes had put in motion the process of legal adjustment to the emerging industrial order, and at a point when mature legal institutions for describing the business enterprise had already developed. The concept of the company limited by share capital, uniting the principles of

limited liability, separate personality and centralized management, was already in place in Germany and France by the 1870s. The company laws of the continent followed the English example set in 1855-6, with some adaptations. There was a clearer distinction between forms suitable for the large enterprise in need of substantial external capital (the *Société Anonyme* and *Aktiengesellschaft*) and those designed for smaller owner-manager or family-run enterprises (the *SARL* and *GmbH*). Most of the emerging industrial enterprises in the final decades of the nineteenth century used one form or the other (with the occasional exception such as Krupp, which was a sole proprietorship until the death of its founder in 1907 but was then incorporated). Organisational integration and the development of a specialized managerial function were a feature of the larger German and French firms (see Kocka, 1980 and Lévy-Leboyer, 1980, respectively). Although they were not the only focus of economic growth, and, indeed, were not typical of the economy as a whole – they existed alongside a larger mass of small and medium-sized enterprises and guild-type economic relations among producers persisted (Herrigel, 1996) – the larger enterprises influenced the development of a distinctive civil law legal model of the firm. By the mid-twentieth century, legal concepts such as ‘entity theory’ and the company’s interest ‘in itself’ stressed management’s duty to maintain the organisational unity of the enterprise as a goal in its own right rather than, as in the common law, a means to the end of returning value to shareholders. Codetermination, which found its strongest expression in the German-influenced systems but also evolved in a somewhat different form in some of the French-origin ones, gave a formal voice to employees and other constituencies within the process of corporate governance in a way which had no equivalent in Britain or in other common law regimes (Pistor, 1999).

The idea that, by virtue of the contract of employment or employment relationship, the worker was necessarily integrated into the organisational structure of the enterprise, was ‘corrupted when it came into contact with a different cultural and political régime: the connection between “work” and “enterprise” was used by the Fascist dictatorships in order to strengthen the principle of authority’ (Veneziani, 1986, p. 66), notable examples being the Nazi labour ordinances of 1934, the Vichy labour charter of 1941 and parts of the Italian civil code of 1942. It was in reaction to this process that in the immediate post-war period, the concept of the employee’s subordination was realigned, with the adoption of social rights at a constitutional and statutory level (in France and Italy) and the legal institutionalization of codetermination (Germany). In Britain, the labour movement did not push for similar legal recognition of worker interests, preferring to rely on tradition of voluntary collective bargaining; the law protected the autonomy of the industrial relations system but, wartime aside, did not regulate it. British ‘voluntarism’ thereby

minimized the role of law, at least at the level of collective labour relations, and further accentuated Britain's exceptionalism within the European context.

### **3.1.3 The role of legal origin in explaining the diversity of market systems**

Thus the 'parent' legal systems of western Europe responded to industrialization, in so far as the law governing the business enterprise was concerned, in distinctive ways, which reflected country-specific conditions. This led to the diversity across national systems that can still be observed today. In each case, private-law concepts of property and contract had to be accommodated to an emerging industrial order. What was the role of legal origin in this process? In particular, how far did the method of codification, which favours the systematisation of legal rules and gives a prominent role to mandatory norms as a technique of legal control, lead to a substantively different kind of legal regime for enterprise? It is possible that it did, but not in the way suggested by the legal origin hypothesis. It is necessary, to begin with, to put aside the idea that code-based systems are necessarily more inclined to statutory solutions than common law ones. In all systems, both courts and legislatures played a part in developing the law of the business enterprise in the nineteenth century; indeed, there is case for saying that most of the innovations were statutory. The claim that the common law favoured emergent or spontaneous solutions over the rational-constructivist ones of the civilian codes is impossible to square with the repeated legislative interventions which shaped both labour and company law and which were inevitably influenced by interest-group activity (during a period when most industrial and agricultural workers had no access to the suffrage). Nor was it the case that the common law produced legal solutions which were more market-orientated than those of the civil law. If anything, the reverse is true: private law concepts were more quickly adopted in the civilian systems thanks to the systematizing effects of the codes and the decisive break they brought about with prior legal structures. Britain was not only slow to discard its pre-modern master and servant legislation and late to adopt the model of the contract of employment by comparison with the continent; when it enacted companies legislation embodying the basic elements of the modern corporate form, its manufacturing enterprises were slow to take it up, in contrast to the widespread use of the same model in civilian systems.

In parent systems, the juridical concepts which were at the core of labour and company law could be said to have been broadly complementary to the particular kinds of work relations and corporate structures which emerged in the different national systems. It is difficult to identify an exogenous role for the legal system in a context where legal norms and economic institutions essentially coevolved. However, it could be said that the experience of parent

systems, and of developed countries more generally, does not provide a good test of the legal origin claim; a better test is the case of systems whose laws and legal infrastructure were imposed from outside through conquest or colonization, or adapted as part of a process of late-stage industrialisation. Is it possible to identify an exogenous effect of legal origin in their case?

### **3.2. The diffusion of legal norms in ‘transplant’ systems**

In the legal origin literature, the claim that legal infrastructure has an independent influence on the development of substantive rules is supported by the cross-sectional regressions which follow the model of the first ‘law and finance’ paper (La Porta *et al.*, 1998). There have been few studies looking in detail at the process of legal diffusion and attempting to chart the mechanisms by which it occurred in particular country cases. Where this has been done, evidence has been found of a distinctive type of legal evolution in ‘transplant systems’. Pistor *et al.* (2003), studying the development of corporate law in a number of developed and developing economies, found that legal rules in systems of origin had changed to a substantially greater extent than those in transplant systems. The latter displayed two types of response: in some cases erratic changes, often involving the reversal of previous policies; and in other cases, very little change over long periods of time.

One possible interpretation of this result is that transplanted laws are not subject to the same process of coevolutionary adaptation with national economic conditions that can be observed in the case of parent systems. However, more work is needed on this question, as there are many mechanisms, in addition to the imposition of laws through colonization, by which legal rules might be diffused. These include regulatory competition, international standard-setting, and the borrowing and adaptation of norms which comes from mutual observation across systems. In principle it is possible to see that systems which share a common legal heritage may, for that reason alone, be more inclined to adjust their laws by reference to a model of a ‘parent’ system or from other countries in the same family; this can occur through linguistic and cultural links of various kinds or through the reduced transaction costs associated with borrowing foreign laws which complement local ones. But there is very little empirical evidence on this question to date.

In the context of work relations, one area of colonial diffusion which has been intensively studied in recent years is the transmission of master-servant legislation to British colonies, a process which began as early as the seventeenth century (in the case of certain American states and the West Indies) and carried on into the twentieth century (in the case of some African countries), well after the repeal of the original laws in Britain. Over the course of the three hundred

years or so, ‘almost 2000 statutes and ordinances made their appearance in more than 100 colonies, developing a colonial master and servant law that drew upon, elaborated, and often subverted the metropolitan models’ (Hay and Craven, 2004, p. 10). The ending of slavery in the Empire in the early nineteenth century and the formal instantiation of freedom of contract was accompanied by the enactment of pass and police laws and vagrancy legislation. Systems of plantation labour in the West Indies and Assam, and mine labour in South Africa, were underpinned by the coercive powers which master-servant law provided to employers. There was also a link to migration and racial segregation. Legislation was passed in several colonies in the 1830s and 1840s for the purpose of regulating the waves of indentured labour (millions of workers) moving around the Empire at that time. These laws created new forms of status around racial and cultural categories. Legislation of this type was being enacted in east Asia, the Caribbean and Africa into the middle decades of the twentieth century.

Whereas in Britain, master-servant laws were used to stabilize the labour supply, reduce the bargaining power of workers and shore up managerial prerogative in the mainly small-scale manufacturing enterprises which were characteristic of the industrial structure of the parent system, in the colonies the same types of laws were used to assist in the dispossession and separation from the land of indigenous populations and to maintain the supply of cheap labour which was essential in plantation and mining-based economies. Plantation systems simply were not profitable without criminal enforcement of labour contracts; and the prosecution rates in some plantation societies were fully fifty times as high as those in parts of England, such as the west Midlands, where the master-servant laws were most heavily relied on by employers (Simon, 1956). In late nineteenth century Trinidad, around one fifth of all criminal convictions involved breach of contract. Enforcement took the form not simply of fines and imprisonment, but of judicially-supervised performance of the work contract, and the addition of extra periods of service as compensation for breaches by the worker (Turner, 2004).

The end of master-servant laws did not come about through economic development. They lingered longest in systems without the democratic suffrage and without recognition of basic labour rights. Britain’s own experience had been similar: it was only as the franchise was extended that the political conditions for the repeal of master-servant laws were gradually established. Across the Empire, notwithstanding some liberalising moves from the Colonial Office which local employers often resisted, it was the pressure of the International Labour Organisation in the 1920s and 1930s and then the

decolonisation process itself which brought about the abandonment of penal laws (Banton, 2004).

The influence of the master-servant model is a good example of a legal origin effect which occurs when transplantation is combined with colonialisation to produce strong path dependencies. This case is, however, further repudiation of the particular legal-origin claim that common law systems were more inherently disposed to a liberal contractual model of work relations than civil law ones. Master-servant law was essentially status-based; that is to say, it preserved distinctions based on class, in the British case, and race, in the colonies. This can be seen from the evolution of the law in South Africa. The master-servant laws there were facially neutral, but with the passage from the middle decades of the twentieth century of industrial relations legislation regulating the mainly (and later exclusively) white occupations, the master-servant regime was applied the agricultural and domestic sectors which were traditionally non-white (Le Roux, 2009). With prosecutions of tens of thousands of workers each year in the 1950s, the master-servant laws became ‘one of the cornerstones of a differential labour law regime’ (Chanock, 2001, p. 424).

#### **4. The legacy of legal origin in the law governing the business enterprise**

How significant is legal origin today as a factor preserving the diversity of national systems and resisting tendencies towards convergence? This is not a question which can be answered on the basis of the initial legal origin studies, confined as they are to the study of the laws of the late 1990s and early 2000s. However, a clearer picture on this issue is now available thanks to recently available longitudinal data based on codings of the law relating to the business enterprise in a number of countries for the period from the 1970s to the present day (see Lele and Siems, 2007, Deakin, Lele and Siems, 2007, Siems, 2008, Armour *et al.*, 2007, 2008, and Deakin and Sarkar, 2008 for a more complete account of these datasets and a discussion of their methodological basis).

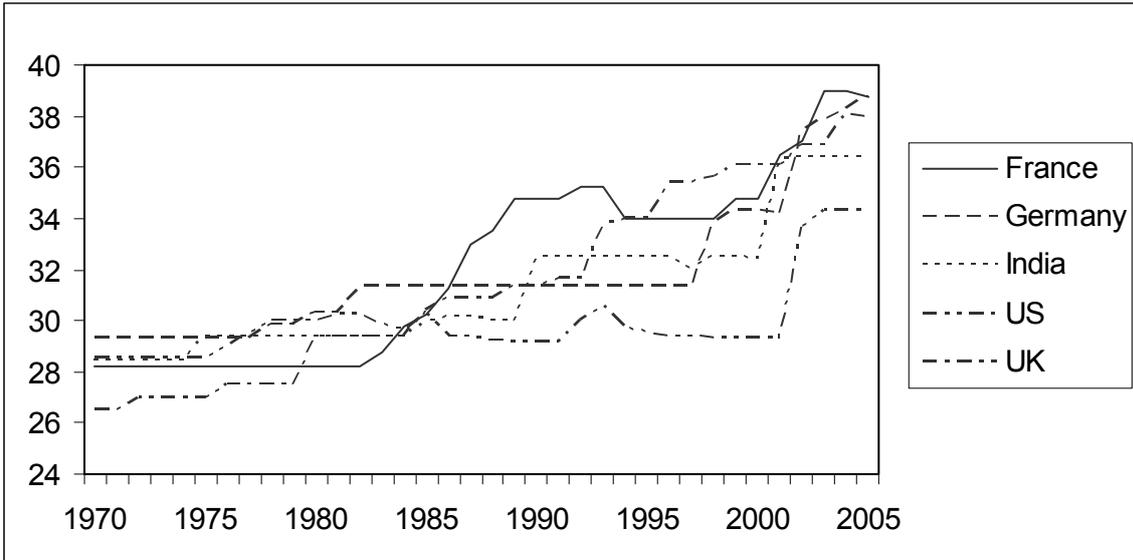
The countries for which longitudinal data relating to this period exist are Britain, France, Germany, India and the USA. The sample of countries is small but these are five important cases (three parent systems; the world’s largest economy; and its largest democracy). Studying a relatively small number of important cases over a long period of time makes it possible to examine trends in legal change in a way which is not possible in a cross-sectional analysis based on a sample of several dozen countries, and to make a more in-depth study of the laws in question, with sources for the values more completely justified. The three areas of law studied are those relating to shareholder protection, creditor protection and labour regulation. In addition, an index of changes in shareholder protection law has been constructed for 20 countries,

covering the period 1995-2006. The sample includes a range of developed, developing and transition systems (Armour *et al.*, 2007).

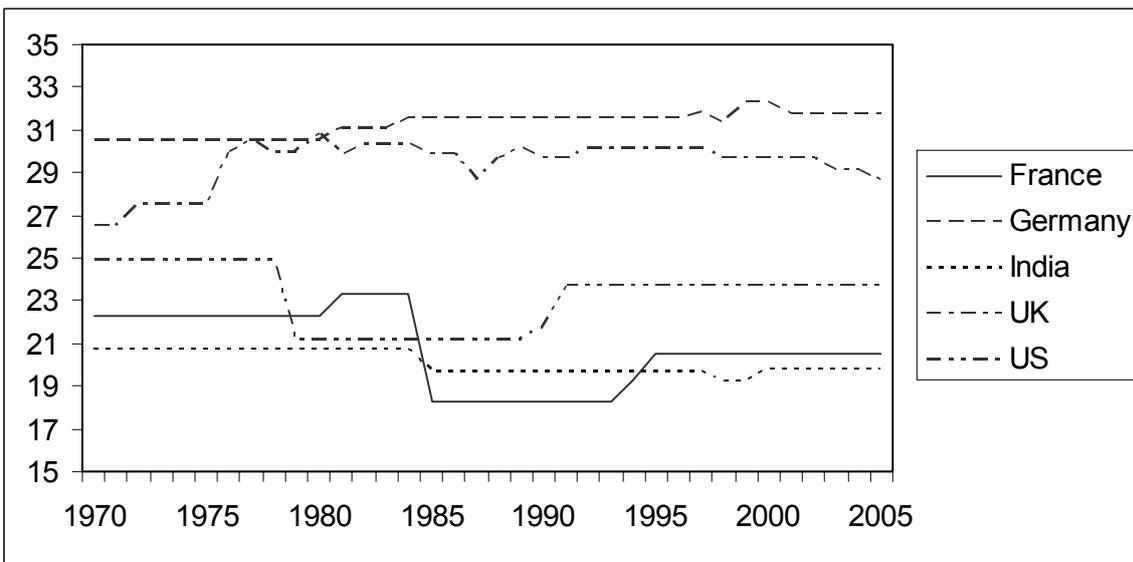
More complete accounts of findings from the analysis of these datasets have been provided elsewhere (see the references set out above); here the main lines of those results will be noted in so far as they throw light on the influence of legal origin today. Figures 1, 2 and 3 illustrate the broad trends in the shareholder protection, creditor protection and labour regulation indices for the five systems in the 1970-2005 dataset. It can be seen that they display very different patterns of change. The shareholder protection index shows a degree of convergence, as each of the five systems has increased its level of protection for shareholders, in particular since the early 2000s. The change has occurred in relation to those rules which protect minority shareholders against over-powerful boards, rather than in those which protect minority shareholders against powerful blockholders; as such, the trend identified here is one of general convergence around a common law model associated with an increased role for independent directors and the market for corporate control in holding managers accountable (Lele and Siems, 2007). A second feature of the trend indicated by the shareholder protection index is that there is no clear distinction between common law and civil law systems. The two civil law systems, France and Germany, score as highly as Britain for much of the period, and more highly than the United States for parts of it.

The larger sample of countries, covering the period 1995-2005, throws further light on what has been happening. Over this period, common law systems had, on average, consistently higher scores on the shareholder protection index, but civil law systems had, on average, a faster rate of increase in the protections accorded shareholders. Again, the pattern is one in which a model which originated in the common law systems has become a global template, around which all systems have recently been converging. Civil law systems have been catching up with the common law paradigm. This finding suggests that legal origin is not a significant impediment to *formal* convergence (Armour *et al.*, 2007).

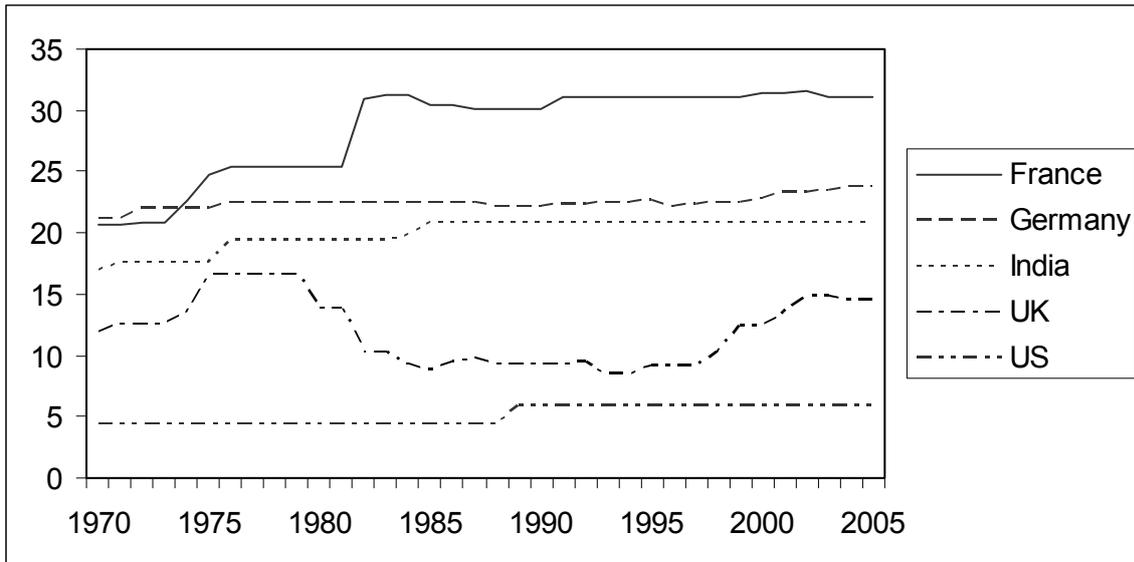
This pattern of convergence is not, however, repeated for creditor protection, which shows persistent diversity which is not related to legal origin: Germany and the UK have the strongest systems of creditor protection, France and America the weakest. The pattern for labour regulation shows the clearest evidence of divergence based on legal origin: scores are substantially higher in the French and German systems than in Britain or the USA, although India, a common law system, comes closer to the German score, overall, than to that of any other country.



**Figure 1:** Trends in shareholder protection in five countries. Source: Shareholder Protection Index (SPI) (Lele and Siems, 2007). The figures in the vertical axis refer to scores based on the indicators in the SPI; the maximum possible score is 60.



**Figure 2:** Trends in creditor protection in five countries. Source: Creditor Protection Index (CPI) (Armour, Deakin, Lele and Siems, 2007). The figures in the vertical axis refer to scores based on the indicators in the CPI; the maximum possible score is 51.



**Figure 3:** Trends in labour regulation in five countries. Source: Labour Regulation Index (LRI) (Deakin, Lele and Siems, 2007). The figures in the vertical axis refer to scores based on the indicators in the LRI; the maximum possible score is 40.

One of the core findings of the legal origin literature has been to identify an effect which was said to be constant across a range of different areas of law: shareholder and creditor rights, court procedure, labour regulation, among others. With longitudinal data available, this result disappears, at least for the five countries for which long time-series data exist: there are different results for shareholder rights (convergence), creditor protection (diversity with no reference to legal origin) and labour regulation (diversity with reference to legal origin). This implies that, at least for this period and these countries, the legal origin effect is not particularly strong; it can be outweighed, for example, by the powerful move towards convergence in shareholder protection, possibly driven by the increase in the global influence of institutional investors and the spread of corporate governance codes as a model for shareholder rights, legitimizing greater controls over managerial discretion (Aguilera and Cuervo-Cazurra, 2004). In the area of labour law, which comes closest to confirming the legal origins claim, it is hard to identify precise legal family-specific influences. There is very little evidence, for example, of the sharing of legal ideas in the labour law field in the common law systems in the sample, or, indeed of any shared experiences. In the period under consideration here, the US law governing employment changed very little, whereas British labour law underwent far-reaching changes which were linked to the political cycle. The experience of the other common law system – India – was, following decolonisation in the 1940s, to reject the master-servant model inherited from Britain, and to adopt labour laws which continue to align it today with the level

of worker protection enjoyed by a civilian regime such as Germany (Deakin, Lele and Siems, 2007).

Although there is little evidence of a trend towards convergence in labour law to match that in company law, some examples can be found of specific diffusion effects which suggest that whatever legal origin effect might exist in the labour law area, it is not a rigid constraint on harmonization. This is the case with the adoption in Britain of laws affecting the choice of alternative employment contracts, the regulation of working time, and employee representation, since the late 1990s. Britain has come closer to French and German practice in this period because it has adjusted to transnational labour standards contained in European Union laws, its common-law origin notwithstanding (Deakin, Lele and Siems, 2007).

The existence of longitudinal measures of legal change also makes it possible to say something about the economic impact of legal change. If the legal origin hypothesis were correct, we would expect to see changes in certain areas of law having substantial, long-run economic impacts. For example, a core tenet of the legal origin approach is that changes to shareholder protection law should be reflected in stock market development. Fagernäs *et al.* (2007), using the shareholder protection index for the period 1970-2005, conduct a time series analysis to see if there is any relationship between the trend in legal change and stock market development over time in France, Germany, the UK and the US, using stock market turnover ratio as the dependent variable. No consistent relationship is found; and for the UK and France, the analysis suggests that there is (somewhat counter-intuitively) a negative relationship. Sarkar (2007) finds no relationship between the trend in the shareholder protection index for India and the stock market turnover ratio there.

Deakin and Sarkar (2008) report the findings of a time series analysis of changes in the labour regulation index for France, Germany, the UK and the USA, also for the period from the 1970s to the present day. After controlling for growth in GDP, they find that the trend in working time legislation is positively correlated with employment growth in France and productivity growth in Germany, and that the trend in dismissal protection is positively correlated with productivity in Germany. There is weak evidence that changes in dismissal law in the United States led to a reduction in the growth rate of employment but there was a countervailing increase in productivity.

Finally, Armour *et al.* (2007) carry out a panel-data analysis for the 20-country dataset which covers changes in shareholder protection the period 1995-2005. They find no statistically significant correlation between the changes recorded

in the dataset, which, as we have just seen, indicate a generally converging trend around the essentials of the common law approach to corporate governance and the market for corporate control, and conventional measures of stock market development including stock market capitalization as a percentage of GDP and the stock market turnover ratio.

These are early results, which reflect work in progress on a larger project of constructing reliable measures of legal change over time and assessing their implications for our understanding of the relationship between law and economic growth. They do, however, cast doubt on some aspects of the legal origin hypothesis, not least the claim that the common law approach to regulation is more likely to produce efficiency-enhancing rules. Aside from pointing to the indeterminacy of the law (given the absence of a clear correlation, either positive or negative, between legal change and economic outcomes in some contexts), they suggest that there is a certain degree of complementarity between the substance of legal rule and the wider institutional framework governing labour and capital markets. This is one implication, at least, of the finding that employment protection laws are more likely to be efficiency-enhancing in a civil law context (Deakin and Sarkar, 2008).

## **5. Conclusions**

The legal origin hypothesis claims that the infrastructure of legal systems – the procedures for adopting, interpreting and applying legal rules, the constitutional relationship between courts and legislatures, and other less formal aspects of legal ‘culture’ or ‘style’ – influences the substantive content of the law in the area of norms governing the business enterprise and, more generally, regulating market activity. Variations in legal infrastructure which correspond to the distinction between common law and civil law legal families are reflected, it is said, in distinct approaches to the regulation of business, with the common law supporting the market order and the civil law tending to control it. These legal variations are linked, in turn, to differences in economic performance across systems.

The legal origin hypothesis has had a considerable influence on policy. It has yet, however, to offer convincing theoretical or empirical bases for the claims it is making. The ‘channels’ through which legal origin is said to work are based on over-stylized descriptions of the common law/civil law divide, while the results it has generated rest on limited data, which capture, at best, differences across legal systems at a particular point in time in the late 1990s and early 2000s, and which even then have been subject to some searching methodological critiques.

In this paper an attempt has been made to analyse the legal origin claim using historical evidence on the long-run development of labour and company law and new panel data on their more recent evolution, since the 1970s in a small but not unimportant sample of countries. The historical evidence highlights the divergent paths taken by parent systems since industrialization. There is a common law/civil law divide, but it reflects the early industrialization of the British case, in which economic change preceded legal and institutional reforms, and the later industrialization of France and Germany, which occurred after the codification of private law. The picture is not one of a more market-friendly common law contrasting with regulation in the civil law. Many complex elements were involved in the emergence of modern labour law and company law concepts; in all systems there was a mix of liberal contractual ideas and punitive regulatory legislation for much of the nineteenth century. Over time the civil law adjusted itself to a model of the firm which accommodated worker voice and an element of social protection in the workplace in return for the integration of the employee into the organisational structure of the enterprise. In the common law, the separation of worker interests from the firm was reflected in a weakly-institutionalised notion of the contract of employment. In this respect, British experience reflected the lingering influence of the pre-modern master-servant regime, which was transplanted to other common law systems via colonisation. The master-servant model ended only with the first moves to universal suffrage, in Britain, and decolonisation, elsewhere.

The experience of industrialization is reflected in the approaches taken by different legal systems to the regulation of the business enterprise. Legal cultures are a potential source of enduring cross-national variation, since they perpetuate institutional solutions to issues of market regulation, often after their initial purpose has been exhausted. However, this does not mean that legal solutions are predetermined by the legacy of legal origin, let alone that such solutions divide neatly, in terms of their effectiveness, along common law and civil law lines. Diversity is the consequence of legal systems being matched (if imperfectly) over long period of time with particular economic configurations. The processes by which legal forms emerge in a way which is complementary to certain economic institutions, but are then transplanted or diffused to alternative contexts, is imperfectly understood. Given what we little we truly know of the legal origin effect, it is premature to use it to construct a model of policy intervention.

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