

The Law and Finance School: What Concept of Law?

Gerhard Schnyder
gerhard.schnyder@kcl.ac.uk

ABSTRACT

Since its inception in the late 1990s, the Law and Finance School has underscored the crucial importance of law in determining firm-level corporate governance features. This paper provides a comprehensive review of 20 years of LFS literature. Comparing the LFS's underlying 'concept of law' to the most important legal theories, it shows that in spite of the centrality of law, the LFS is based on a surprisingly 'thin' theory of law. In particular, the LFS has very little to say about the mechanism that links law to firm-level practices. In other words, while a great deal of effort has gone into empirically showing *that* law matters for corporate finance and governance outcomes, much less effort has been spent on the question *how* we would expect law to matter. The paper argues that this is a major neglect that not only limits the theoretical contribution of the LFS, but also undermines empirical strategies used to test the link between law and economic outcomes. In this sense, contrary to existing criticisms of the LFS, the main issue is not that the LFS overstates the importance of law, but rather that it does not take law seriously enough. The paper shows that this has important implications for empirical research and develops empirically testable propositions regarding the link between law and corporate governance practices.

1. Introduction

Institutionalist management scholars have argued for some time that many influential theories in management studies, such as agency theory, adopt a “thin view of institutional environment[s]” (Aguilera & Jackson 2003: 449). Surprisingly, this tendency can even be observed in fields that attribute much importance to the explanatory power of institutional factors. This paper focuses on the so-called Law and Finance School (hereinafter LFS), which has become an important stream of research in comparative corporate governance over the last twenty years (Aguilera & Jackson 2010). The LFS is crucially based on the notion that “law matters” for economic outcomes: The quality of a country’s company law and its “legal origin” are said to determine key features of companies’ corporate governance system, such as ownership concentration and corporate finance choices (e.g. La Porta, Lopes-de-Silanes, Shleifer and Vishny (henceforth LLSV) 1997, 1998, 1999, 2000).

In spite of its extraordinary influence both among scholars and policy-makers, the LFS has come under a great deal of criticism (e.g. Deakin et al. 2011; Armour et al. 2009; Milhaupt & Pistor 2008; Aguilera & Williams 2009; Spamann 2010). One line of criticism points out that the LFS exaggerates the importance of law and neglects the influence of other factors – such as history and politics – on corporate governance and finance patterns (Coffee 2000, Cheffins 2001, Roe & Siegel 2009, Roe 2006, Dam 2006). The LFS has reacted by resorting to increasingly broad definitions of “law”, watering down somewhat the original claim that it is indeed the *substantive* aspects of a country’s laws that matter for corporate governance. Instead, what matters are broad features of a country’s legal and political system captured by the notion of “legal origin” (cf. La Porta, Lopes-de-Silanes, Shleifer (henceforth LLS) 2008).

Contrary to these well-known criticisms and the LFS’s reaction, the present paper argues that the LFS’s problem is not that it takes law too seriously, but that it does not take it seriously enough. Put differently, the paper suggests that the solution to the criticisms of the LFS should not be to abandon the investigation of how *substantive* differences in laws affect differences in corporate governance outcomes. Rather, we should develop a more solid theoretical framework of *how* we would expect law to matter. In order to do that, we need to draw more on legal theory than the LFS has done. Legal theory has been used to great effect to advance management theories, where such theories are oftentimes needed, but rarely explicitly marshalled (see van Oosterhout et al. 2006, Lan & Heracleous 2010).

Based on key dimensions of law derived from legal theory, the paper addresses the following research question: What are the theoretical assumptions regarding the nature, function, normativity, and impact of law on economic outcomes that inform the LFS research programme?

It finds that despite the confident statement that “law matters”, an extensive review of two decades of literature suggests that the LFS simply does not provide any consistent theory of law explaining *how* legal factors impact economic actors and outcomes. Indeed, the LFS draws on various strands of legal scholarship, but the “concept of law” that emerges is not coherent and indeed may at times be inconsistent across different studies. We argue that this is a serious neglect, which not only explains why it has proven surprisingly difficult to clearly establish an empirical link between legal factors and corporate governance outcomes (see Schiehl & Martins 2016, Coffee 2001, Cuomo et al. 2012), but also limits the theoretical contribution of the LFS to comparative corporate governance.

The implication for future research is that if we are interested in testing the question “does law matter?” it would seem important to first ask the question “why and how do we expect law to matter?” The latter question hinges, in turn, on a clear conceptualisation of the link between laws and firm-level practices. This paper attempts to contribute to this task by providing empirically testable hypotheses that take into account core insights from legal theory, which the LFS neglects.

The paper proceeds as follows: Part two summarises the key claims of the LFS. Part three briefly presents different legal theories and identifies three key dimensions of every concept of law. Part four reviews what the LFS literature has to say about how law impacts firm-level outcomes in order to identify the underlying ‘concept of law’. Part five presents alternative conceptualisations of the link between law and firm-level outcomes and develops testable propositions. A last part concludes.

2. The Law & Finance School

The Law and Finance School is a 'legal approach to corporate governance' (LLSV 2000: 4) associated with a series of influential papers co-authored by La Porta, Lopez-de-Silanes, Shleifer, and Vishny (henceforth LLSV), the first of which was published in 1997. It is broadly speaking cognate to New Institutional Economics and Law and Economics with both of which it has affinities, but also certain differences. The key argument and main novelty of LLSV's work was that the "quality" of a country's company law determined different corporate governance outcomes (size of stock markets, type of corporate finance, ownership structure). This is often referred to as the "quality of law" thesis (Armour et al. 2009). However, rather quickly, the focus of the LFS shifted from measuring the *substantive* quality of different laws – and indeed law *per se* –, to a more fundamental claim, namely that economic outcomes are determined not so much by the substantive content of laws, but by historically-grown features of a country's legal and political system. The LFS distinguishes four different "legal origins" based on the grounding of countries' laws in four "mother systems": English Common Law, French-, German-, or Scandinavian Civil Law. According to the empirical evidence presented by the LFS, common law legal origins are generally associated with superior outcomes (e.g. LLSV 1998: 1126). This alleged superiority of common law was first attributed to the substantive quality of law and more precisely the level of property right protection law affords investors (e.g. LLSV 1997). Increasingly, however, the LFS considered the difference to result from more fundamental and even philosophical differences between common law countries and others. Most fundamentally, Mahoney (2001: 511) considers that the difference boils down to common law countries defining "liberty" based on the Humian-Lockian tradition as individual liberty, while civil law countries follow the Hobbesian-Rousseauist tradition of seeking to achieve liberty through collective goals pursued by the state. This, in turn, implies that the 'legal origins theory' is essentially about the level of state intervention in the economy (also LLS 2008). The increasingly broad definition of legal origins also leads the LFS to the verge of rather culturalist arguments about the superiority of certain civilisations over others. LLSV (1997b: 333) essentially argued that Catholicism and Islam are inferior to Protestantism in terms of economic outcomes, because they prevent the emergence of 'horizontal trust' among people. LLSV (2004: 445) explicitly state that there are "significant benefits of the Anglo-American system of government for freedom." In parallel, to this change in the explanatory variable, the dependent variables too have become increasingly broad, moving from the initial focus on ownership structures and market capitalisation, to a variety of outcomes including firm- and country-level economic growth (Levine 1999; Beck et al. 2000), political and economic freedom (La Porta et al. 2004), and even military conscription, which can all be explained by legal origins (for a summary see LLS 2008).

Consequently, the very designation of this line of research as ‘Law & Finance’ has become a misnomer, because the focus has increasingly been on broad political characteristics and the role of the state in different countries than about the content of laws. Partly, this shift happened as a result of ongoing criticisms of the LFS’s conceptualisation and methodology to measure substantive characteristics of “good” company law. This is an unfortunate development, because it diverts our attention away from the key challenge of explaining not just *that* law matters, but also *how* it matters. Indeed, a central thesis of the present paper is that the shift in the LFS from the “quality of law” as the main explanatory variable to “legal origins” has considerably weakened the analytical power of the LFS approach and has undermined the initial attempts to contribute to our understanding of the impact of law on economic outcomes. In order to renew the initial ambition of the LFS to investigate the impact of law on economic practices and outcomes, this paper proposes a detour via legal theory (for other attempts see Deakin et al. 2015; Milhaupt & Pistor 2008). In particular, the paper uses the notion of ‘concept of law’ to assess what the LFS has to say about law. This notion will be further developed in the next section.

3. Concepts of Law

This section attempts to define the ‘concept of law’ underlying some of the historically most important theories of law.¹ I distinguish three related but distinct dimensions of a ‘concept of law’ along which I will compare these theories. The first and most fundamental dimension of any concept of law concerns the definition, nature and fundamental functions of law, which is indeed the key question any theory of law attempts to answer (Raz 2009: 47) (columns 3 and 4 in table 1). This is related to questions such as “what is law?”, “what is the function of legal rules?” (“commands,” “decisions,” “rules”, “plans”, “legal obligations”) and “what are its sources of authority or validity?” The second dimension concerns the perennial question of the separation of legality and morality, the definition of “good” law, and more broadly its “normativity” (Table 1; columns 5 and 6). A third dimension – related to the second one – has to do with the specific mechanisms through which law deploys its effect on its subjects, i.e. how does it create reasons for action (compliance) (table 1; column 7).

I discuss five very influential legal theories along these three dimensions: natural law theory, strong legal positivism, inclusive legal positivism, legal realism, and Hayek’s spontaneous order theory of law (see table 1). The similarities and differences across theories will then allow us to assess the LFS’s underlying concept of law in section 4.

3.1. The Nature & Function of Law

¹ I borrow the notion ‘concept of law’ from Hart’s (1961) classic book. According to Raz (2009: 19), Hart used the term to mean ‘explanations of the nature [...] of the law.’

While the LFS confidently states that “law matters,” arguably it does not have much to say about *how* law should be expected to matter. Legal theories that attempt to explain the nature of law and where law’s (claim to) authority and validity come from and how they are deployed can contribute to answering these questions (Raz 2009).

Broadly speaking, most authors would probably agree that law is a “social institution” or a “system of social control” (Hart 1961) that aims at guiding behaviours of humans living in society. Within this broad definition, however, there are persistent disagreements about the origin/sources of legal rules and the main functions law fulfils.

Natural law theory is often associated with Enlightenment scholars (John Lock, Montesquieu, and Jean-Jacques Rousseau) but also with scholastics (Thomas Aquinas) and contemporary Christian lawyers notably John Finnis (2011[1980]). Put crudely, natural law theory states that legal rules guiding human behaviour necessarily have to conform to – substantive (Finnis 2011[1980]) or procedural (Fuller 1964) – moral standards to be valid or at least to have full obligatory force. There is hence a partial but necessary overlap between moral standards and the positive law that applies in any given human society.

‘Exclusive’ or ‘strong’ legal positivism – often associated with John Austin (1832) and Jeremy Bentham (1843) – reject the natural law legal theory. Instead, it adopts the ‘Social Fact-’ and the ‘Conventionality Theses’. These theses claim that legal validity is ultimately based on certain social – not natural – facts such as formal promulgation of laws. Laws are authoritative because of social conventions legitimising them (Himma, no date). Based on these theses, positivism holds that anything a legally unlimited sovereign declares to be law is law. Law is hence a social construct that takes the form of ‘commands’ produced by a – possibly secular and amoral – authority.

Legal realism, which is associated with proto-realist Oliver W. Holmes (Green 2005) and early 20th century US lawyers such as Karl Llewellyn, departs from this positivist view by introducing the so-called “decision theory.” It states that law is not what the legislature declares to be the law, but rather what judges decide. These decisions can be based on the legal rules specified in statutes, but may also be determined by judges’ non-legal considerations (Green 2005: 1918). This is legal realism’s “rule-scepticism”, which states that legal rules are a “myth”, because statutes and other sources of law are indeterminate. What counts is what judges decide.

Inclusive- or soft legal positivism – associated with the work of HLA Hart (1961) –, is in line with strong positivism in terms of the source of law being a sovereign’s decisions. However, it rejects strong positivism’s focus on the duty-imposing function of law. Indeed, law’s key function of guiding human behaviour often implies imposing legal duties to do or refrain from doing certain things. Much of liberal legal theory for instance focuses on the duty to refrain from infringing other people’s liberty and

property (the “protective function” of law, Milhaupt & Pistor 2008). More generally, the duty-imposing function of law is the main focus of Austin’s strong legal positivism (“law as command”). Hart, however, criticises Austin’s “coercive theory” stating that the duty-imposing aspect of law may be an accurate description of criminal law, but not necessarily of other types of law. Thus, law also has power-conferring aspects: Rather than imposing restrictions on actors’ behaviours under the threat of sanctions, laws also enable certain actions that would not be possible without the law (e.g. entering contracts, establishing companies, issuing securities etc.). This hints at a broader function of law: Rather than a purely constraining force, law also has enabling and coordinating function (Shapiro 2011; Milhaupt & Pistor 2008). By the same token, law also has a constitutive function in the economy: Just like the rules of football do not just regulate the corner kick, but actually create it in the first place, law does not just regulate the economic “game”, but creates it through the rules and institutions that it puts at actors’ disposal (cf. Deakin et al. 2015).²

A further aspect of the nature of law, according to Hart concerns the distinction between primary and secondary legal rules. He defines a legal system as the union of primary rules, which are rules guiding the behaviour of the subjects of law (‘law takers’), and ‘secondary rules’, which are rules that establish how valid law is adopted and changed.

In his evolutionary-functionalist “spontaneous order” theory, which can be considered a fully-fledged theory of law (Ogus 1989), F. A. Hayek takes up this functional distinction. In *Law, Legislation & Liberty* (2013[1982]: p.125 and FN19), Hayek (2013[1982]) cites Hart (1961) and distinguishes “rules of just conduct” (primary rules) from “rules of organisation of government” (secondary rules). Primary rules are, in Hayek’s view, the original type of laws, which guarantee a society’s liberty. They are substantively defined as negative “rules of just conduct” protecting individuals’ private sphere from interference by the state and others. They constitute together the system that he calls *nomocracy*, which allows him to distinguish rules of just conduct (*nomos*) from “other commands called law” (Hayek 2013[1982]: 200). Rules of just conduct are negative in that they do not normally impose positive duties on people, but negative duties to abstain from certain conducts (Hayek 2013[1982]: 202). Indeed, while Hayek’s account of liberty relies – contrary to more libertarian accounts – very strongly on law, the purpose of law is narrowly defined as “merely [serving] to prevent conflict and to facilitate co-operation by eliminating some sources of uncertainty” (Hayek 2013[1982]: 204). Following this narrow definition, Hayek explicitly rejects Hart’s distinction between duty-imposing rules and power-conferring rules (Hayek 2013[1982]: 201). This view in turn derives from Hayek’s narrow conception of justice as merely being the

² The neglect of law’s enabling effect, has a direct correspondence in institutional scholarship more broadly: Jackson and Deeg (2008) observe that much of institutional scholarship in management studies sees institutions purely as a constraints on economic actors, neglecting, thus, their enabling effect.

absence of injustice (cf. Gamble 2013) and it explains why the protective function of law becomes the main function of law on his account.

Secondary rules, on the other hand, are identified with 'public law' and defined as rules that determine state coercion. As such they are only acceptable if they aim at enforcing primary rules (Hayek 2013[1982]: 130). All other secondary rules constitute a 'corruption' of the legal system, which aim at imposing state policies or the interests of certain interest groups on the population. This is the basis for his criticism of legal positivists of whom he says that "all the leading modern legal positivists have been public lawyers and in addition usually socialists" (Hayek 2013[1982]: 211).

3.2. (Good) Law, Morality, and Normativity

The second dimension relates to the question of the normativity of law, which is often discussed as the question whether law needs to meet certain standards of morality or whether the two are separate. However, Raz (2009: 2) argues that "moral reasons are only one kind of (normative) reasons" and other normative reasons need to be taken into account too, which is often done under the label "normativity of law."

The strongest stance on the necessary link between law and morality can be found in natural law theories. Natural lawyers have argued that there are certain objective standards derived from the laws of nature (or of God) that form a basis against which the 'goodness' of positive law can be judged. Morality (defined by the natural moral standards) and legality ought to coincide for law to be valid, i.e. 'immoral law' is not law at all.

Strong legal positivism explicitly emerged as a reaction to 'natural law' theories. Famously, Bentham (1843: 5) commented on the French Declaration of Rights of 1791 that "[n]atural rights is simple nonsense: natural and imprescriptible rights, rhetorical nonsense,—nonsense upon stilts." Instead, based on the "Social Fact Thesis" positivists claim that law is law because of the social fact that it is enacted by a sovereign who is habitually obeyed, but does not habitually obey anyone, i.e. the sovereign is legally unlimited. Therefore, laws do not have to follow any particular moral standards or social norms to be valid. What the sovereign decides to be law is law irrespective of its content. Law and morals are separate. Legality is not the same thing as morality ("Separability Thesis") and immoral law is still binding law. The most influential representative of this school of thought in the 20th century was Hans Kelsen (1967) who added to exclusive positivism the notion of the existence of a *Grundnorm* (basic rule) which founds the legitimacy of a given sovereign and hence the legal system.

The Inclusive positivism of Hart attenuates the strong "Separability Thesis" of legal positivists and realists by introducing the so-called "practice theory of rules". Most positivists share the fundamental notion that law is a social construct, which is based on

certain social facts (Himma 2002: 1153). For Austin this social fact was the existence of a sovereign. For realists, who share with strong positivism the notion that the “normativity of law” – i.e. its appeal to citizens’ moral standards – is irrelevant, the social fact is the decisions made by judges in court. The novelty of Hart’s theory is that the key social fact is the existence of a binding Rule of Recognition. The Rule of Recognition is the fundamental secondary rule in whose acceptance by officials the legitimacy of the legal system resides. This rule comes close to Kelsen’s “basic rule” except that Hart sees it as a “social rule”. Hart’s “practice theory of rules” (Hart 2012[1961]: 254-5) conceives of rules, not as defined in a substantive or normative way, but rather as social practices that are generally used and accepted as guides for action (Hart 2012[1961]: 89; 255). *Acceptance* refers to group members generally following the rule and condemning deviating behaviours, but not necessarily agreeing with the rule on normative grounds (Perry 2006). While there is an ongoing debate about the source of normativity in Hart’s concept of law (Dworkin 1977; Moore 2000; Green 2005; Green 2015, 2012), the “practice theory of rules” opens up positivism to the possibility that the ultimate reason why a legal system is considered legitimate may well be moral or customary. That is to say, while according to Hart legal obligations created by primary rules are not moral obligations (that is his positivism), the reasons for acceptance of the fundamental Rule of Recognition may well be its grounding in moral standards or customs, which can be held to be “objective.”

In this respect, Hart’s concept of law has parallels with F. A. Hayek’s explicitly customary spontaneous order theory. Hayek (2011[1960]: 115-6) conceives of law as a “spontaneous order” that crystallises as a result of a process of “adaptive evolution” through the survival of the fittest rules. Yet, contrary to Hart’s positivism, Hayek’s concept of law is based on a substantive definition of what valid law is. While acknowledging the existence of a Rule of Recognition, he rejects Hart’s claim that the acceptance by a society’s officials of such a rule constitutes a sufficient basis of validity for positive law (Hayek 2013[1982]: 130). In order for law to be valid, it also needs to conform to certain substantive criteria, most importantly ‘negativity’ and ‘universality’. Negativity implies that valid law should be limited to negatively defining what conducts the subjects of the law have to *refrain from* in order not to infringe on others’ private sphere. Universality is in turn defined as a negative test which assesses whether rules are ‘end-independent’, i.e. they do not attempt to achieve a specific outcome, and that they only refer to facts which can be known or readily ascertained by all rule-takers (Hayek 2013[1982]: 205). This departure from Hart is not surprising given Hayek’s aversion for legal positivism. While Hayek (2013[1982]: 220) calls Hart the most effective critique of older forms of legal positivism, the fact remains that Hart’s theory is still a positivist one, which essentially provides a purely formal definition of valid law.

Hayek shares the realists focus on judges, he does not seem to accept their “rule scepticism.” Rather, he follows Ronald Dworkin in that he agrees with the latter that

legal systems are more than a “system of rules” in that it also contains less explicit elements that Dworkin (1977) calls “principles” and Hayek himself calls “unarticulated” or implicit rules (Hayek 2013[1982]: 315). Indeed, law-making in Hayek’s sense is not creating legislation that pursues specific goals, but applying general (customary) principles to specific cases (Ogus 1989). One can see that there is only a small step from this conception of proper law making to considering judge-made law in a common law system as the ideal form of law-making.

3.3. Law as Reason for Action: motivations and law’s impact on rule-takers

One of the most important questions to elucidate why we would expect law to matter for economic outcomes concerns the motivations of (economic) actors to obey the law.

In natural law theory, the main reason why subjects comply with the law is “practical reason”: Because the law’s main purpose is to *coordinate* human interactions for the group to achieve the “common good”, reasonable actors will comply with the law. Beyond practical reason, naturalists such as Finnis (2011[1980]) stipulate a moral obligation for people to obey the law.

Again, strong legal positivism diverges from natural law theory in this respect, rejecting the “normativity of law”, and claiming instead that laws are nothing else than commands backed by threats of punishment (Austin 1832). This view is often referred to as the command- or coercive theory of law.

Legal realism has further refined strong positivism’s focus on the threat of punishment as main motivator for citizens to obey the law. Holmes famously used the notion of the “bad man” as the main addressee of laws. He considered that the bad man’s incentives to avoid “doing bad” simply derived from the costs associated with punishments, not from any moral condemnation of illegal activity. Holmes (1897: 459) wrote:

“If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict.”

This statement is the fundament of legal realism’s “prediction theory” of law, which states that it is the subject’s prediction of the ruling, and hence of the likelihood of punishment, that guides private citizens’ behaviour (Green 2005).

Therefore, both exclusive positivists and legal realists seek the motivation of actors to obey the law in external incentives and *subjective* reasons for action, i.e. the calculation by an amoral actor of the likelihood to get caught and punished. On this account, law does not provide *objective* reasons for action.

Hart’s (1961) inclusive positivism rejects the coercive- and prediction theories’ focus on litigation and punishment to explain why the average citizen obeys the law. “The

principal functions of the law as a means of social control are not to be seen in private litigation or prosecutions, which represent vital but still ancillary provisions for the failures of the system.” (Hart [1961]2012: 40). Indeed, officials and law-abiding citizens obey the law out of a moral conviction that laws ought to be obeyed. In other words, laws establish legal obligations, which people follow *because* they are the law not because of a rational calculation of costs and benefits associated with the likelihood of punishment. In other words, punishment is law’s “plan B” (Greene 2012, 2015). “Plan A” is to rely on law’s *normativity* not its coercive side. Law therefore provides objective reasons for action, which strong positivists and realists deny (Green 2005).

On this point too, Hart’s view is compatible with Hayek’s theory who states that enforcement is – or ought to be – law’s “plan B”. For Hayek, it is crucial for the existence of society that rules are “habitually obeyed” and coercion only needs to be applied in exceptional cases (Ogus 1989: 395). The habitual obedience derives from the customary nature of legal rules, i.e. their congruence with a society’s social norms. While unenforced rules cannot be considered law, Hayek still considers that the existence of a centrally organised system of sanctions is not a necessary condition for the existence of a legal system (Hayek 2013[1982]: 200). Thus, rules that are enforced by social pressure or ostracism can be considered law too, as long as the rules conform to the criteria of valid law (generality, universality and negativity). This is where the departure from Hart’s positivism emerges most clearly: In Hart’s (1961) view, the existence of a system of secondary rules is the defining element distinguishing a system of law from more archaic, pre-modern types of customary and tribal systems of social rules. Hayek (2013[1982]: 314-5) rejects this view, stating that a legal system does not necessarily require secondary rules. Indeed, Hayek (2012[1982]: 69) famously held that “law is older than legislation.”

The debate about the reasons for action that law creates being either subjective (threats of punishment and incentives) or objective (moral obligations and duties) is still on-going today (see Schauer’s [2014] book-length defence of the coercive view and Green’s [2015] reply). One reason why the normative view may be difficult to accept for certain scholars is the “model of man” that different theories are based on. Coffee (2001: 2165) argued that theories based on a purely rationalistic model of man have a hard time accepting any role of norms in the economy, focusing on coercion instead (Coffee 2001: 2165). Rationalistic models of man clearly have dominated much of management and economics scholarship in recent years. However, the normative view of law – and the associated model of man not just as a rational maximiser, but as a being driven by social obligations and moral duties – has recently received support from empirical studies on human behaviour notably in the area of behavioural law and economics (Jolls 2006). On this account, law may be able to influence the way people behave not just through the threats it makes or through the incentives it creates, but also through the moral norms of appropriateness of certain acts that it signals. This

comes close to what Sunstein called the expressive function of law, which he defined as “the function of law in ‘making statements’ as opposed to controlling behavior directly” (1996: 2024). Such statements can be important elements in shifting behaviours via the signalling of appropriate/desirable behaviours and by changing social norms. Milhaupt and Pistor (2008: 34) contend that “[o]ften, the signals sent by law may be more potent or novel than the legal provisions themselves”. An important implication of this view is that the law may deploy its effect quite independently of the question whether it is actually enforced or not (Deakin et al. 2015). Indeed, Sunstein (1996: 2032) shows that certain laws are unaccompanied by enforcement and threat thereof, but that they still “[...] can help reconstruct norms and the social meaning of action” and hence guide behaviours.

A further implication of the signalling function of law is an inversion of the notion that law ought to reflect a society’s moral norms. Green (Green 2013: 483) considers that laws can actively shape a society’s morality by helping to “[...] create new meanings of certain acts”. The prime example Green provides is the criminalisation and decriminalisation of certain acts:

"The creation of crimes normally aims to make people accept, or to take more seriously than they already do, the idea that the relevant delict is not merely prohibited or officially disapproved, but wrong. (Green 2013: 483).

Similarly, Robinson and Darley (2007: 28) argue that “[c]riminal law is perhaps unique in its ability to inform, shape, and reinforce social and moral norms on a society-wide level.” The view that the normative function of law not only explains how law affects law-takers’ behaviours, but also can shape the morality of the society as a whole, constitutes the strongest version of a normative view of law.

The next section reviews the LFS literature and attempts to classify it in terms of its proximity with existing ‘concepts of law’ along these three dimensions identified in this section.

4. The “Thin” Concept of Law in Law & Finance

This section provides a comprehensive review of the body of literature that can be considered the core of the LFS. To this effect, a list of all articles published by the four original authors (LLSV) since 1997 was compiled based on their personal web pages and online Curricula Vitae. Articles that did not focus on legal or institutional factors as key explanatory or dependent variables, but only included them as controls and articles that did not refer to the LFS’s main claims were excluded (e.g. Chong et al. 2014). Similarly, papers that did have legal factors as their key variables, but focused on areas unrelated to management studies (e.g. Djankov et al. 2010 on disclosure regulations for

politicians) were also excluded. Several articles by other authors were added if they could be considered to be closely related to the LFS tradition, because they are repeatedly and approvingly cited by LLSV. Overall, this left us with 47 articles published between 1997 and 2015, which can be considered to constitute the core of the LFS (Table 2). From this body of literature, this section attempts to distil the concept of law that underlies the LFS. In order to achieve this, the above-mentioned three dimensions will be considered.

4.1. The nature and function of law according to the LFS

Explicit discussions and definition of the nature and function of law in the economy are scarce in the LFS. However, there are different hints and elements that allow us to piece together what role law plays in the economy according to the LFS.

As noted above, it is certainly a key contribution of the LFS to have brought “law” into the debate on what determines differences in national corporate governance systems. In this respect, institutional factors are important and the LFS can therefore broadly be categorised as a New Institutional Economics (NIE) approach (LLSV 1999), which in turn has overlaps with the (new) Law and Economics school.³ However, LLSV are clear on distinguishing their approach – which they call “legal approach to corporate governance” in some of their papers (LLSV 2000a) – from the Law and Economics school. Thus, LLSV (2000a: 7) state that “[t]he emphasis on legal rules and regulations protecting outside investors stands in sharp contrast to the traditional ‘law and economics’ perspective on financial contracting.” Indeed, they reject the more libertarian ideas in the field, which consider – based on the Coase theorem (Coase 1960) – that rational actors will find optimal solutions to allocation problems via market forces and private contracts, as long as the contracts are enforceable (Stigler 1964; Easterbrook & Fischel 1991; Fama 1980). In such situations no market regulation is required to achieve optimal outcomes. Tort- and contract law will suffice. The LFS rejects this view and emphasises the importance of laws and even government regulation in certain – albeit limited – circumstances (LLSV 2000a: 7). Glaeser and Shleifer (2002: 1223) argue that “[e]conomists generally agree that the state's main role in the economy is to protect property rights. [...] The trouble with this imperative is that it does not tell us exactly how the state can design a functional legal system, and what it takes to ‘protect property rights’.” Therefore, an important goal of the LFS is precisely to identify the circumstances under which different institutional choices – including legal rules – are optimal to protect property rights.

Three interrelated arguments in favour of public regulation can be found in the LFS literature. Firstly, public regulation may be more efficient than a system of pure private litigation in countries where the general level of “law and order” is only “moderate”

³ Posner (1993) for instance considers Coase as a founder of both the L&E and the NIE schools.

(Glaeser and Shleifer 2003: 403).⁴ Secondly, depending on the “enforcement environment,” public regulation may be a better choice than private litigation. This is for instance the case when contracts are complex and judges may not have the required specialised skills to enforce them, while a specialised public regulator may (LLS 2006; Djankov et al. 2003: 605; Glaeser & Shleifer 2002). Thirdly, broad socio-economic factors may affect the choice of the optimal regulatory regime. High levels of economic and political inequality favours the subversion of courts by powerful litigants, leading to a situation where the “strong” not the “just” win court cases, making public regulation a better choice (Glaeser & Shleifer 2002; Glaeser et al. 2003).

In sum, the LFS treats the choice of the optimal regulatory regime as an empirical question depending on the “enforcement environment” and other factors, which leaves room even for state intervention and regulation. To be sure, state intervention is always only a second best solution and the domain of market failures making it necessary is “extremely limited” (Shleifer 2005: 440; also Glaeser and Shleifer 2003). Still, the LFS ascribes to law a more important and potentially more benign role than the traditionally more libertarian Law and Economics literature.

The benign function law plays can more precisely be defined as one of property right protection (LLSV 1997: 1149; LLSV 1999: 222; Mahoney 2001: 523). The protection of minority shareholder rights is necessary because of agency problems, namely the risk of expropriation of shareholders by insiders (see Jensen & Mecklin 1976). In such a situation, the law confers shareholders “certain powers to protect their investment against expropriation by insiders” (LLSV 2000b: 3), which in turn creates incentives for financiers to make external finance available to companies, allowing them to grow faster (Levine 1999). Legal shareholder protection will also lead to dispersed ownership structures because companies choose to finance their activities by issuing new stock, which dilutes the holdings of families and entrepreneurs (e.g. LLSV 1997, 1998, 1999, 2000a).

Milhaupt and Pistor (2008) have criticised the LFS precisely for exclusively focussing on the protective function of law.⁵ However, some of the LFS articles do contain a

⁴ It should be noted that there is possibly some circularity in the argument here: “law and order” is not defined at the outset of the paper, but p.423 refers to Coase 1960 and equates “securing property rights” with “establishing law and order.” Interpreted like this, the argument does border on tautology in the sense that they investigate what institutional choices are optimal to secure property rights depending on different levels of “law and order,” which in turn is defined as the extent to which property rights are (*de facto?*) protected. An alternative interpretation could be that “law and order” is considered to be a more general tendency among a country’s population to respect the law or follow rules. This could possibly be interpreted as a Weberian understanding of legitimacy, i.e. that, in general, laws are accepted to be binding (cf. Green 2013: 489), which however raises the question whether such a view is compatible with the LFS’s non-normative view of law (see below).

⁵ The notion “function of law” has no single definition in legal scholarship. It is used to designate the purpose or consequences of law at various levels. The function of law is sometimes very broadly defined as in “guiding conduct” (e.g. Fuller 1969) or *constituting* the rules of the game (the “constitutive function”

somewhat more variegated view of the functions of law than the usual narrow focus on the protection of property rights. Thus, Djankov et al. (2003: 596) state that:

“Since the days of the Enlightenment, economists have agreed that good economic institutions must secure property rights, enabling people to keep the returns on their investment, make contracts, and resolve disputes.”

Here, two additional functions of law are mentioned, which provide some clue about the underlying concept of law. Firstly, “enabling people [...] to make contracts” hints at the enabling- or coordinative function of law rather than its protective one. This function consists in providing actors with instruments such as contracts that help them coordinate their economic activities with other actors while negotiating the precise allocation of property rights within the boundaries of the law (Milhaupt & Pistor 2008: 7). Acknowledging the existence of enabling legal rules would suggest a certain proximity of the LFS’ concept of law with Hart’s inclusive positivism who makes this distinction most clearly (cf. *supra* section 3). Secondly, solving disputes is a function of law that mainly relates to the laws’ enforcement through litigation, which is key to legal realism. Enforcement has become an increasingly important concern for the LFS and will be discussed below.

Nevertheless, while some papers suggest a broader conceptualisation of why law is expected to matter, Milhaupt and Pistor (2008) are right in saying that this is done only in passing and there is no discussion of the theoretical or empirical implications of this multi-functionality of law on the causal link between law and economic outcomes.

4.2 What is “good” law? – Legality and Morality

The second dimension that allows us to assess the concept of law underlying the LFS concerns the debate about whether law has to respect certain extra-legal standards to be considered valid or “good” law, or whether anything the sovereign decides to be law is law independently of its content and form. Given the centrality of the “quality of law” claim, it would seem inevitable that there is indeed a definition of “good” law. The LFS extensively uses normative terms like “good law”, “good governance”, “good government”, “improve”, “better”, to characterise legal systems and changes therein (e.g. LLSV 1997a: 1194; LLS 1999: 505; 2000: 6, 20; Glaeser et al. 2003: 272). However, quality or ‘goodness’ in the LFS are not directly used in a normative or moral sense, but rather in a technical and seemingly objective one. This section shows that there are indeed at least three different definitions of “good law” in the LFS.

The so-called quality of law claim is central to the early studies in the LFS tradition (LLSV 1997, 1998, 1999, 2000). The LFS uses a *technical* definition of the quality of law, which

of law; Deakin et al. 2015) to more specific, but still broad ones, e.g. “doing justice” (Moore 1992), “licensing coercion” (Dworkin 1988) and “coordinating activity” (Finnis 2011[1980]). In this article I use the term “function of law” in an everyday sense without a specific scientific meaning.

essentially equates the “goodness” of law with the degree to which it protects shareholders against certain actions by insiders. The LFS developed an empirical measure of this quality of law, i.e. the so-called Anti-Director Rights Index (ADRI).⁶ Due to various criticisms of this measure (e.g. Spamann 2010; Braendle 2005; Armour et al. 2009), Djankov et al. (2008) developed an alternative measure called the Anti-Self-Dealing Index (ASDI), which is not based on coding ‘black letter law’ but on a survey of legal practitioners (Djankov et al. 2008). The flip-side of this definition of quality of law as the degree to which it prevents certain behaviours is a *substantive* definition of good and bad behaviours. Consider the following passage in Johnson et al. (2000: 3), defining “tunnelling” transactions:

“[T]ransactions [of ‘tunnelling’] include outright theft or fraud, which are illegal everywhere though often go undetected or unpunished, but also asset sales, contracts such as transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees, expropriation of corporate opportunities, and so on.”

Similarly, Johnson, Boone, Breach and Friedman (2000b: Footnote 1) state that

“many forms of stealing are actually legal in countries with weak legal environments.”

Djankov et al.’s (2008) above-mentioned ASDI measures the extent to which minority shareholders can oppose self-dealing transactions by controlling shareholders. The focus is explicitly on transactions where “a controlling shareholder wants to enrich himself *while following the law*” (Djankov et al. 2008: 432; emphasis added).

These passages show a striking separation of positive law and the judgement of certain behaviours not so much as legal or illegal, but good or bad. Certain behaviours and transactions are categorised as undesirable (or ‘bad’) *even when the positive laws of the country in question do not prohibit them*. The implication is that ‘theft’, ‘fraud’, etc. have an objective existence independent of the positive law in a given country. Therefore, the question arises on what normative basis the assessment is made that minority shareholders *ought* to have a right to prevent certain transaction or to sue for damages if they do take place. The most explicit passage in this respect is Johnson et al. (2000: 11):

⁶ This index was simply the sum of six dummy variables, which measured different shareholder rights that were – according to LLSV’s assessment – crucial for shareholders to make sure they get “their money back” (cf. Shleifer & Vishny 1997). The six variables included in the ADRI are “Proxy by mail allowed,” “Shares not blocked before AGM,” “Cumulative voting / Proportional representation,” “Oppressed minority rights,” “Pre-emptive rights to new issues,” “percentage of shareholders needed to call extraordinary AGM” (La Porta et al. 1997).

“[In civil law countries] [s]elf-dealing transactions are assessed in light of their conformity with statutes and not on the basis of their fairness to minorities.”

The reason why “self-dealing” is considered inherently bad is the general principle of “fairness to minorities,” which is independent of what the positive law says. The LFS does not explain, however, where the principle of fairness derives its authority from. Still, the “quality” of a country’s laws is assessed against extra-legal standards, which are not explicitly part of the country’s positive law (and maybe not even of its social norms). The LFS therefore acts on the assumption that laws have to conform to certain normative principles (such as fairness) to be considered ‘good’ or even valid. To some extent, this assumption is built into the legal origin premise of the LFS, which states that common law is “better” than civil law, because it allows judges to go beyond the statutory rules when defending shareholder interests (see *supra* section 2).

The above discussion suggests that the LFS defines good law mainly in terms of how well it protects (shareholders’) property rights. However, other passages in LFS studies hint at quite different definitions of what defines good law. One of them is a functionalist, outcome-orientated definition. Thus, LLSV (1999b: 223) explicitly define “good” as what is “good-for-economic-development”. Similarly, Hay and Shleifer (1998: 401) state in a passage defining “good law” that “some rules facilitate trade better than others.” The outcome of facilitating trade and economic activity more generally constitutes hence a substantive criterion for good law.

Still other LFS studies refer to a *non-substantive* criterion for “good” law, which is rather an efficiency criterion, namely the extent to which law is enforceable in a given context. Thus, LLSV (2000a: 22) state:

“[G]ood legal rules are the ones that a country can enforce. The strategy for reform is not to create an ideal set of rules and then see how well they can be enforced, but rather to enact the rules that can be enforced within the existing structure.”

Here, the ease with which a law can be enforced becomes a measure of the quality of law, which is related to the extent to which it reflects the community’s standards. Hay and Shleifer (1998), for instance, define “good rules” via their acceptability: “good legal rules are those likely to be adopted by private parties for both structuring and enforcing their transactions, as well as used by courts” (Hay&Shleifer 1998: 401). The definition of ‘good law’ is here – contrary to the substantive quality of law claim – a purely pragmatic one (acceptance), which does not presuppose any specific substantive content of legal rules. Glaeser and Shleifer (2002: 1202) suggest that this may be one of the reasons for English common law’s superiority: The decentralised judiciary implies that “community standards of justice” are more closely reflected in the legal system.

This hints at a – at times explicitly – customary concept of law in the LFS. Shleifer (2005: 443) explicitly relativizes the role of legislation compared to custom: “With courts, there is a role for impartial judges enforcing rules of good behaviour. These rules do not need to come from legislation, but may instead derive from custom or from judge-made common law and precedents.” Similarly, Hay and Shleifer (1998: 402): “Whenever possible, laws must agree with prevailing practice or custom.”

There are hence at least three different definitions of good law in the LFS. A first one is narrow and focused on the extent to which law protects shareholders’ (property) rights, where rights are defined substantively following certain principles such as “fairness;” a second focuses on outcomes, assessing good law based on the economic outcomes it produces (growth, trade, markets); a third one is focused on the efficacy and indeed legitimacy of law with a view to its enforcement and hence effectiveness. The LFS does not provide any direct clues how these different definitions of good law related to each other. It is indeed an open question whether these definitions are compatible with each other or not.

What does seem clear, however, is that these definitions could be associated with different theories of law. The first-, “protective” definition of good law seems most closely related to the natural law theory. Various LFS studies explicitly refer to the long pedigree of the “protective function” of law, citing Smith (1776), Montesquieu (1748), and Locke (1690) as the main sources for the insight that “good economic institutions must secure property rights” (Djankov et al. 2003a: 596; also Djankov et al. 2003b: 453; Glaeser et al. 2003: 200; 2004: 272; La Porta et al. 2004). Several of these classical authors have affinities with natural law theories (notably John Lock and Montesquieu), which may suggest that the LFS view is inspired by a naturalist concept of law (see above section 3).

To some extent, the LFS view of law seems hence close to natural law theory, which is based on the notion that certain moral rules and principles are objectively good (e.g. Finnis 2011[1980]). Fairness may be one of them. The second, functionalist and outcome-orientated definition is closest to Hayek’s substantive definition of good law as favouring markets and trade. The third definition of good law is based on the enforceability of law thanks to its proximity to community standards and hence its “acceptability”. As mentioned above, this also leads to the claim that supposedly decentralised common law may be superior to more centralised, statute-based civil law. This claim has been made by various legal scholars including Lon Fuller (1964) who considered that common law was characterised by a small gap between legal and moral claims, which facilitates enforcement and hence the efficacy of law. This is because common law essentially consists in deriving legal implications from the views commonly held by the people in a society (Fuller 1964: 50). Enforceability as criterion for good law also resonates with Fuller’s (1964) procedural naturalist view more broadly. Fuller (1964) argued that to be considered (good) law, law needed to fulfil its primary function

of guiding behaviours. Only laws that respect a range of procedural principles can do that effectively. These principles define the law's internal morality. Enforceability of law, while not in Fuller's list of principles⁷, very much resembles such a functionalist, procedural criterion for "good law." However, the broad claim that laws need to be close to "community standards" is also compatible with various other legal theories, which refer to the customary or conventional nature of law. The focus on proximity with community standards and on acceptability recalls indeed Hart's (1961) "practice theory of rules." As mentioned above, Hart's theory relies on the assumption that at least some of the rules in a legal system need to be "social rules" in the sense that they are both commonly practiced and considered legitimate guides for action by most in the community (see *supra*). This pragmatic and non-cognitivist view of rules (Perry 2006) seems in line with the concept of law that the LFS adopts. However, LFS's view is also vulnerable to the same criticism as Hart's conception of rules as social practice. Indeed, it is at best a partial description of what law is notably because it cannot account for non-conventional rules that also exist in a society (see Dworkin 1977).

However, the LFS's customary view of laws is probably most closely related to Hayek's spontaneous order theory of law. Besides explicitly Hayekian papers (Mahoney 2001), different LFS publications refer to Hayekian concepts. Thus, La Porta and Shleifer (2009) and Djankov et al. (2003) base their conceptualisation of legal procedure and its impact on the economy on an explicitly Hayekian analysis (also LLSV 1999, Glaeser & Shleifer 2002, Beck et al. 2005, 2003). Djankov et al. (2003: 600) cite Hayek's evolutionary view as one among others that may explain how efficient laws emerge. Hayek's account does indeed seem compatible with various claims of the LFS discussed in this section. Thus, the narrow definition of the quality of legal rules in terms of the protection they afford individuals against other individuals and against the state (Djankov et al. 2003) is very much in line with Hayek's definition of good law as composed of negative 'rules of conduct' (cf. *supra*). Also, both the definition of good law in terms of its conduciveness to trade and market-based economic systems and in terms of law's proximity with community standards is compatible with Hayek's substantive and customary definitions of legal rules. Finally, the implication of Hayek's theory of law that decentralised political systems will produce better outcomes than centralised systems, because they

⁷ Fuller (1964: 39) lists eight principles of legality any valid legal system must conform to:

"(P1) the rules must be expressed in general terms;

(P2) the rules must be publicly promulgated;

(P3) the rules must be prospective in effect;

(P4) the rules must be expressed in understandable terms;

(P5) the rules must be consistent with one another;

(P6) the rules must not require conduct beyond the powers of the affected parties;

(P7) the rules must not be changed so frequently that the subject cannot rely on them; and

(P8) the rules must be administered in a manner consistent with their wording" (Himma, no date).

draw more on local knowledge and limit state interference is clearly taken up by LFS scholars (cf. especially Glaeser & Shleifer 2002 and Mahoney 2001).

However, there are also aspects regarding which the LFS seems to depart from Hayek. Most importantly, Hayek's notion of *nomocracy* is based on a resolute rejection of goal-orientated systems (*teleocracies*). Any system that aims at instrumentally using law to achieve specific collective goals is subject to the erroneous naivety of "rational constructivism" and "pragmatism" (Hayek 2011[1960] especially chapters 10, 15, 16). He writes: "legal positivism, like the other forms of constructivist pragmatism of a William James or John Dewey or Vilfredo Pareto, is therefore profoundly antiliberal in the original meaning of the word, though their views have become the foundations of that pseudo-liberalism which in the course of the last generation has arrogated the name" (Hayek 2011[1982]: 209). Hayek's theory rejects hence both legal positivism – whom he reproaches its absence of a substantive definition of valid law – and marginalist economists for the instrumental and teleological-utilitarian paradigm according to which law can be used to achieve certain collective goals. The LFS, on the other hand, does contain a clear utilitarian, instrumentalist, and ultimately teleological slant, notably regarding the feasibility and desirability of legal reform (e.g. Hay & Shleifer 1998). Hayek only considers law to be real law that is historically grown and emerged from a process of evolutionary progress towards efficient rules not in the sense of their outcome, but in the sense of creating a Great Society where individuals' liberties are optimally protected from interference by others and by the state. The LFS notion of efficiency or optimality of a regulatory regime is a different one. For instance, Glaeser and Shleifer (2002) and Djankov et al. (2003) consider the rise of the statute-based regulatory state in the US during the progressive era and the relative decline of a purely court-based private litigation system of the 19th century, as an efficient adaptation to a new, more complex economic and social environment. This can be seen as broadly in line with certain functionalist-evolutionary theories that interpret the crisis of legal formalism as a result of the increasing complexity of society (see Teubner 1981). Hayek (2011[1960]; chapter 16) on the other hand saw this evolution not as an efficient choice, but rather part of the regrettable "decline of the rule of law," due to the rise of "constructivist pragmatism" and socialism, which once again hints at the LFS's more benign view of regulations compared to economic liberals.

To sum up, the LFS literature contains more than one definition of what good law is and only implicitly addresses its link with morals. It does become clear, however, that the LFS adheres to the view that there is such a thing as "good law". Based on this observation, the LFS clearly cannot be considered a legal positivist view of law, because legal positivism rejects the notion of substantively good law. For instance, for legal positivists, the acts that are outlawed as "theft" and "fraud" only become "theft" and "fraud" once the law defines them as such. There may be social norms that consider "theft" and "fraud" morally condemnable, but there is no reason to assess the quality of

the law against such external moral standards. The positivist conception of law is quite explicitly rejected in the LFS. Thus, in a rare explicit reference to legal theory, LLS associate legal positivism, which they summarise as conceiving of law as the “expression of the will of the legislator as supreme interpreter of justice,” with the socialist legal tradition, which they clearly reject (LLS 2008: FN2).

The LFS’s school rejection of positivism has a further implication, which is that the “constitutive function” of the law, which is inherent in positivist accounts, is neglected in LFS studies. The social constructivist aspect of legal positivism implies for instance that concepts like ‘theft’ and ‘fraud’ are creations of the law not naturally given phenomena (cf. Deakin et al. 2015; Sarat & Kearns 1993). This view goes against the LFS account of substantive standards for morally good and bad principles and norms.

4.3 How does law guide actors’ behaviours?

If we accept the basic idea that law matters, because it is an important mechanism of social control that works by guiding actors’ behaviours, the mechanisms through which law achieves this goal becomes a crucial object of inquiry. The legal theories summarised in table 2 can essentially be divided into two groups: those that consider that law provides people with objective reasons to obey (moral obligation and practical reason) and focus hence on the normativity of law; and those who only consider subjective reasons for action (self-interest, fear of punishment, habit of obedience). This section seeks to identify the mechanisms that the LFS postulates and which concept of law this corresponds most closely to.

A first observation is that LFS literature clearly comes down on the side of the “subjectivist” view in that the law is attributed only “subjective reasons” for action. Although, there is no explicit discussion of how exactly law makes actors do what it prescribes, there are some broad references to the *incentives* that law creates for different actors, which influences their behaviour (e.g. LLSV 1997, 1998). Incentives are the domain of rational calculation by self-interested actors and hence firmly in the “subjectivist” camp.

This becomes even clearer when considering the very strong focus of much of the LFS on law enforcement. The idea that law is only law if it is properly enforced was present in the LFS from the beginning (Milhaupt and Pistor 2008: 5). But enforcement has progressively taken on an even more important place. The LFS analyses different factors affecting enforcement: The competence and incentives of judges (Glaeser et al. 2001; Glaeser & Shleifer 2002), the degree of subversion of courts by particular interests (Glaeser et al. 2003; Glaeser & Shleifer 2003), the quality of government and its impact on enforcement more broadly (LLSV 1999). Shleifer (2005: 442) even calls his approach to regulation an “enforcement theory of regulation” in the sense that it is the

“enforcement environment” that determines the choice of the optimal system of social control of the economy (a court-based litigation system or public regulation).

In a more recent series of papers, the LFS has turned to analyse adjudication in common law countries in more detail still, focussing on judicial practices such as the role of precedents, “overruling”, “distinguishing”, and discretion in fact finding (Gennaioli and Shleifer 2007a, 2007b, 2008, Niblett et al. 2010). These papers zero in on adjudication and ask questions about the application of legal rules by judges; including their decisional biases (notably Niblett et al. 2010). These papers explicitly adopt a legal realist view, which argues – according to the “decision theory” of law – that law is what the judge says it is. This “legal realist turn” of the LFS can be traced back at least to 2007 and in particular to the joint work of Andrei Shleifer with Nicola Gennaioli (Gennaioli & Shleifer 2007a, 2007b, but also Balas et al. 2009, Niblett et al. 2010, Gennaioli et al. 2014).

It is the increasingly pessimistic view of human nature that explains this recent focus on the role of judges. Contrary to Coasians such as Stigler (1964) or Easterbrook and Fischel (1991) who were optimistic about the sufficiency of private contracts and their enforcement in courts of law for efficient outcomes, the LFS applies the *homo oeconomicus* model not just to the contracting parties, but to judges as well. It asks the crucial question ‘why should judges care about the shareholders’ interests rather than their own?’ (see Glaeser et al. 2001, Glaeser & Shleifer 2002, Shleifer 2005) It is the application of the *homo oeconomicus* concept to judges, that makes the LFS less optimistic about courts and the optimality of a litigation-based systems than other Law and Economics scholars associated with the Chicago School of Economics (Shleifer 2005; Djankov et al. 2003). In this respect, the realist approach certainly makes a contribution to the literature to the extent that it challenges more optimistic accounts of judge-made law, which may overestimate the efficiency of such systems. Interestingly, in a paper co-authored with Shleifer and Niblett, Posner himself – previously an advocate of the view that common law is efficient (Posner 1973) – has provided evidence that contradicts the notion that common law converges to efficiency thanks to “adversarial adjudication” (Niblett et al. 2010). However, the realist turn has also had the effect of further focussing the LFS’s analytical lens on punishment, coercion, and enforcement, diverting attention from the fact that law may not impact actors only when it is being enforced in a court of law (e.g. Deakin et al. 2015). The realist stance and the focus on enforcement reveal an underlying concept of law which realism shares with strong positivism, i.e. that the threat or anticipation of punishment is the main motivation for people to obey the law. In this respect, the legal realist turn of the LFS sheds light on the underlying ‘model of man’ that legal realism and the LFS share.

Several passages illustrate this point. Gleaser et al. (2003: 201) quite explicitly state that the only reason why powerful actors would respect the law is the fear for punishment:

“If the politically strong expect to prevail in any court case brought against them, they would not respect the property rights of others.” (also Glaeser et al. 2001). Furthermore, Shleifer and Wolfenzon (2002) explicitly attempt to combine Becker’s (1968) economic model of “Crime and Punishment” with Jensen and Meckling’s (1976) agency theory. They define the quality of investor protection not through a list of legal shareholder rights, but as “likelihood that the entrepreneur is caught and fined for expropriating from shareholders.” (Shleifer & Wolfenzon 2002: 4). This statement is remarkably close to Holmes’s (1897) “prediction theory of law” according to which law should be defined simply as the prediction of how courts will decide and what the likelihood of punishment will be. Defining law in this way implies hence basing it on a pessimistic anthropology where actors do not follow the law for the sake of following it, but to avoid punishment. It is in this respect that Holmes’s view seems compatible with the LFS’s underlying conception of the *homo oeconomicus* who in their pursuit of maximal utility is not responsive to norms and duties, but only to cost-benefit considerations and incentives. This may explain why the LFS is quite naturally drawn to a realist view of law.

The LFS’s focus on the “bad man” also leads to the neglect of normative mechanisms linking law to law-takers’ behaviours, which make it incompatible with concepts of law that are based on the notion that law creates ‘objective reasons for action’ (see table 2 column 7). Thus, the Beckerian-Holmseian view of human motivation starkly contrasts with Hart’s theory, which is based on the law-abiding citizen rather than the “bad man.” Thus, Hart (2012[1961]: 40) famously asked: “Why should not law be equally if not more concerned with the ‘puzzled man’ or ‘ignorant man’ who is willing to do what is required, if only he can be told what it is?” Hart observed that the majority of people hold the view that it is their duty to obey the law for the sake of obeying the law, rather than as the result of a conscious calculation of costs and benefits associated with the likelihood of punishment.

To some extent, however, this stance also contradicts the previously established proximity of the LFS with Hayek’s concept of law, who was – as mentioned above – very critical of the pragmatist philosophy to which Holmes was close. Hayek considered indeed that habit and tradition were what drives compliance with law, while coercion only was a last resort (Hayek 2011[1961], chapter 9).

4.4 Summary and Discussion

To sum up the review of the first twenty years of LFS scholarship in terms of the underlying concept of law, it emerges that the LFS diverges from other branches of Law and Economics and New Institutional Economics in the importance it ascribes to laws and regulations. Nevertheless, very few papers in the LFS tradition explicitly state what concept of law the studies are based on. Indeed, most studies are surprisingly vague on key issues with respect to law’s role in the economy or their implications (what is law?

How does it impact actors and economic outcomes?). Indeed, some of the – often implicit – assumptions that emerge from the analysis of these articles appear at least in part to be contradictory.

Thus, the LFS rejects legal positivism's claim that the validity of laws is determined simply by the will of a sovereign. Instead, it adheres to the view that laws need to fulfil certain substantive criteria to be considered "good" law. Conversely, not everything that is enshrined in the law can be considered "proper" or valid legal rules. Thus, legal rules that do not conform to the moral principle of fairness are considered sub-optimal. This hints at a quasi-naturalist, non-positivist view of law, which states that law needs to conform to certain extra-legal standards. The definition of what exactly these standards are, however, remains vague. "Good law" has to protect individual (property) rights, favour trade and economic growth, but also closely reflect a community's own (moral) standards and practices. The LFS does not tell us which one should prevail if these goals are not aligned. Moreover, it is not entirely clear what this substantive definition of the validity and quality of law is based on. While the LFS literature does contain references to natural law or natural rights theories of property rights, it seems more likely that the underlying concept of law can most closely be associated with a Hayekian evolutionary view of law.⁸

Regarding the precise mechanisms linking law to actors' behaviour, the LFS clearly focuses on subjective reasons for obeying the law, not objective and normative ones. In the earlier studies, this question is largely treated implicitly and reduced to questions of incentives that *investors* have due to effective protection of their property rights or the absence thereof. Surprisingly little is said about how company law affects the other main addressees of legal rules on shareholder protection, i.e. the "insiders" who are the ones doing the expropriating in the LFS framework. This question is only answered implicitly in the sense that the strong focus on law enforcement suggests that the mechanism linking law to behaviours is fear of punishment. In this respect, despite the rejection of positivism regarding the source of authority and the definition of law, in terms of the mechanism through which law guides actors' behaviours, the LFS does seem close to the Austinian exclusive positivism and the Holmsonian legal realism. Both theories adopt the command- or coercive theory of law, which sees fear of punishment to be the only reason why subjects would obey the law. This also makes the LFS conception of law compatible with modern economic theories about rationality and motivation, in particular with Becker's (1968) work.

The focus on fear of punishment as main effect of law on its subjects, also explains the important place that enforcement occupies in the LFS. In this respect, judicial decision-making is key to different LFS arguments. Initially, judges applying broad *legal principles*,

⁸ Hayek saw indeed his spontaneous evolution theory of law as a third way of explaining law beyond positivism and natural law doctrines (Hayek 2013[1982]: 223).

as opposed to “bright-line legal rules”, to specific cases was considered a key advantage of common law systems over civil law ones. This insight has a distinct Hayekian ring to it. Increasingly, however, the LFS has moved to a more pessimistic and explicitly legal realist understanding of the role of courts and judges.

This discussion of the features of the concept of law underlying the LFS has to be seen against the backdrop of a more general trend in the LFS literature towards a *decreased* importance of law as an explanatory variable. Indeed, the above-described move from a series of quite specific substantive features of a country’s company law as captured in the ADRI and ASDI to very general features of its political, cultural, and socio-economic environment implies that law has lost considerable ground in terms of explanatory primacy. Some of the LFS studies go even further adopting practically a non-institutionalist position. Thus, Glaeser et al. (2004) argue that *policies* of investment in human capital are a more important driver of economic development than institutions and the rule of law. Indeed, on this account, “good” policies are often adopted by dictatorial regimes, and “good institutions” follow afterwards (Glaeser et al. 2004: 271). One could argue, therefore, that the more recent scholarship in the LFS tradition can hardly be considered to be about law *per se* anymore and that the name Law and Finance School has become somewhat of a misnomer.

This latter development is regrettable, because it means that the LFS has reacted to difficult questions raised by the initially confident statement that “law matters” not by attempting to answer the important question “how does law matter?” but by avoiding the debate altogether, shifting the focus onto more fundamental features of different countries’ socio-political system rather than refining the causal theory of law in the economy. This would seem like a crucial enterprise in particular for an applied economics approach that very much focuses on the empirical investigation of its main claims. Indeed, in order to develop robust empirical tests of its main claims, it would seem that the LFS’s main problem is not that it takes law too seriously, but rather that it does not take it seriously enough.

So far, this paper has reviewed the LFS literature with a focus on its theorisation of law. Yet, much of the LFS literature is empirical in nature and focuses on the key question of the impact of law on various firm-level and country-level economic outcomes. The next section turns to that link between law and outcomes and its empirical investigation. It argues that the theoretical limitations identified in this section have important empirical implications. It attempts to develop a more robust framework based on legal theory and on insights from current legal studies and shows how such a framework can enrich the LFS concept of law in order to make the theory both analytically and empirically stronger.

5. Empirical Implications: Towards empirical strategies that match legal theory

The preceding review shows that the concept of law underlying the core LFS articles is partial at best and contradictory at worst. The key question that arises from this observation however is: How does it matter? Is it not sufficient for a theory in the area of applied economics to correctly predict the outcomes of interests (cf. Friedman 1966[1953])? The problem with this view is that the LFS has been challenged not just on theoretical, but also on empirical grounds. The predictive power of the theory does not seem anywhere near as strong as it may appear based on the popularity of the theory (e.g. Spamann 2010; Braendle 2005; Armour et al. 2009, 2007). Partly, the lack of robust results may precisely be due to the lack of a coherent conceptualisation of how law matters, which leads to questionable empirical strategies that, in turn, undermine the LFS's theoretical contribution to corporate governance research. A recent systematic review of the comparative corporate governance literature provides support for this claim: Schiehl and Martins (2016) show that the LFS variables "legal origin" and "investor protection" (mostly measured through the ADRI) are by far the most common country-level factors used as independent variables in cross-country governance research. Yet, the eighty-nine studies reviewed only find consistent evidence for an impact of these country-level variables on two firm-level governance variables; namely ownership structure and financial market development. For all others, "the evidence on the effects of country-level factors on the use of other firm-level governance mechanisms and their effectiveness is considerably less consistent" (Schiehl & Martins 2016: 195). The authors show that "country-level variables are conceived and applied differently across studies" and argue "[...] that a more conscientious match between theorized associations and empirical tests would be essential for developing a [...] rigorous and relevant global theory of comparative corporate governance" (Schiehl & Martins 2016: 195).

This section turns to briefly reviewing empirical studies, which apply the LFS theory in order to investigate the impact of law on economic outcomes. It aims at contributing to the development of a more rigorous theory of comparative corporate governance by explicitly deriving testable proposition from the legal theories mentioned above.

Most empirical studies on the impact of law on corporate outcomes use LFS variables such as legal origin and the ADRI without any discussion of how they are expected to impact firm-level corporate governance outcomes. Some do not explicitly develop that theoretical link themselves, but simply reiterate the LFS's above-mentioned property rights protection story (e.g. Peng & Jiang 2010: 261). Others integrate the LFS's claims within a broader institutional approach (cf. Peng et al. 2008; 2009). They often consider law as just one of various types of formal and informal institutions that matter for the outcomes at hand. Thus, Hoskisson et al. (2005: 945) state that market institutions include "a strong legal system to provide aggressive enforcement of property rights and a brake on opportunism, graft, and corruption." Zattoni et al. (2009: 512) state that "[i]nstitutional theory emphasizes the influence of socio-cultural norms and values, as

well as the effect of law and the judicial system, on organizational structure and behavior (North, 1990)" (also Peng et al. 2009). These authors lump together law with other institutions without considering the specificity of how law impacts economic outcomes.

Using 'institutions' as a catch-all phrase to encapsulate law and other formal and informal institutions necessitates a broad conceptualisation of institutions' impact on economic outcomes, because the mechanism has to be reduced to the smallest common denominator among a variety of institutional factors. Peng et al. (2009: 66) for instance, postulate a broad functionalist view according to which institutions' "[...] most fundamental role is to reduce uncertainty and provide meaning." Laws, like other institutions are hence broadly defined as the "rules of the game" that constrain actors' behaviours, make them more predictable, and reduce uncertainty. More fundamentally, institutions impact economic actors by determining the (transaction) cost structure of an economy and by creating incentives – positive and negative – or by directly punishing certain types of transactions and favouring others. Hoskisson et al. (2005: 942/3) in a study about the impact of legal reforms on emerging market business group strategies state that "[a]s the underlying transaction costs are reduced because of these [market-orientated institutional] changes, large diversified business groups have an increased incentive to restructure (refocus) so as not to incur excessive organization costs" (also e.g. Chung 2001 for a tax incentive explanation of the emergence of Taiwanese business groups). The focus on costs and incentives is indeed a dominant trend in much of the institutionalist management and international business literature (Jackson & Deeg 2008).

More sophisticated empirical studies that do develop a theoretical and conceptual framework for the impact of law on economic outcomes at some length, mostly relate the LFS variables to Scott's (1995; 2008) theory of three institutional pillars (e.g. Schnepfer & Guillen 2004). Scott explicitly distinguishes the regulatory pillar from the normative and cognitive ones. Scott (2008) acknowledges that the three "elements" deploy their effects through different mechanisms and are associated with different motives for compliance and claims to legitimacy. The normative pillar is associated with moral authorisation, the cognitive one with cultural support and taken-for-grantedness (Scott 2008: 419). The regulatory pillar on the other hand is explicitly associated with "coercive isomorphism" and hence with the coercive effect of laws and regulations (Scott 2008: 428). According to Scott (2008: 429) compliance with the regulatory pillar is due to the motive of "expedience," which in turn he defines as avoiding punishment. Therefore, even the most sophisticated empirical studies follow Scott and reduce laws to the coercive view. Scott (2008: 430) does acknowledge that in the long term legal coercion can "transmute" into normative and cultural-cognitive elements, but in the short run, what counts is the threat of coercion. The focus on coercion may explain why

the broader institutional view is considered by these authors to be compatible with the LFS's view on laws.

A few studies do exist that do not subsume law under the broader umbrella of "institutions." Yet, they often still fail to specify exactly what causal mechanism links law to economic outcomes. Schnepfer and Guillen (2004: 264), for instance, state that their study attempts to explain "how a country's political, legal, and social structures tend to elevate the rights of certain classes of stakeholders while demoting those of others." Here, laws are seen as politically-constructed rules that confer (or limit) certain stakeholder rights, which in turn can be transformed into power through (the threat of) enforcement in a court of law. Judicial decisions, informed by different legal concepts of the corporation, are seen as key determinants of the power distribution among stakeholders in any given country (Schnepfer & Guillen 2004: 268). In this sense, such studies acknowledge the constitutive role of law, but reduce it to the extent to which it determines actors' power through the protection of their rights (cf. Schnepfer & Guillen 2004: 271).

Such a focus on law's impact on stakeholder power may make sense when the outcome variable of interest is indeed a practice that is subject to power struggles among different stakeholder groups of the firm; e.g. hostile takeover bids (Schnepfer and Guillen 2004). Here, "shareholders will be better positioned to pressure boards of directors into considering unwelcome bids" when they have more power grounded in more extensive legal rights (Schnepfer & Guillen 2004: 273). For other outcome variables, however, this conceptualisation may make less sense, because the power factor may be irrelevant. Consider for instance the two outcome variables for which Schiehl and Martins (2016) find the strongest evidence that legal factors matter, i.e. ownership concentration and market capitalisation. Neither of them are pure managerial choice variables, as they are mainly determined by factors that lie outside the firm-level decision making process. Given that such outcome variables are not completely under managerial control, the power struggles are a less important determinant of such practices. The impact of law on these outcomes must hence stem from another mechanism.

Given that the theoretical link between law and corporate governance outcomes is only marginally considered in the empirical literature, it comes as no surprise that most studies use rather generic measures of legal factors. Indeed, most empirical studies simply use general measure of legal minority shareholder protection (e.g. the ADRI or the ASDI) to measure the legal level independently of whether it contains any legal rules directly affecting the practices under investigation. LLSV's (e.g. 1997) studies use the legal measure as a broader proxy for the legal environment and are interested in broader outcome variables (ownership structures) rather than firm-level practices that correspond with legal provisions. Moreover, oftentimes these firm-level variables are

not managerial choice variables, which makes the link between law and corporate outcomes even more strenuous. Similarly, Schnepfer and Guillen (2004) use the ADRI to investigate the impact of law on hostile takeover activity, although this legal measure does not contain any rules on hostile takeovers. Similarly, Cuomo et al. (2012), in a study investigating the link between legal reforms and companies' corporate governance practices in Italy, use the ADRI and other country-level measure of legal shareholder protection, none of which capture all aspects of the legal reforms that have taken place in Italy.⁹ More importantly, these measures do not focus on the same aspects of corporate governance that Cuomo et al. (2012) use as dependent firm-level variables. The ADRI does not contain any measures for ownership structures, the existence of pyramid structures or syndicate agreements among shareholders, which are the control-enhancing mechanisms that Cuomo et al. (2012) investigate. An increase in the ADRI does hence not directly affect any of the investigated firm-level practices.

Such research designs go against the coercive view of law, which would suggest a relative limited impact of law on corporate practices, i.e. *ceteris paribus* only when a specific practice is directly targeted by the legal change would we expect a company to react by changing its practices. If a company practice goes against the spirit of the law (e.g. increased shareholder protection), but not against its letter, we would not expect the company to worry about it. Indeed, if fear of punishment is the main driver of compliance, there is no reason to believe that companies would change their behaviours unless they are threatened with punishment. Consequently, if the coercive effect were the only, or even the main effect of legal rules on corporate practices, empirical studies should focus on investigating the direct correspondence between legal variables and firm-level variables, e.g. the prohibition of dual class shares in the law and their existence at firm level. A longitudinal study could then investigate whether a given corporate practice changed before or after the relevant legal rule changed, which would make possible conclusions regarding the impact of law on corporate governance practices. Surprisingly, however, very few studies adopt this empirical strategy corresponding to their implicit conceptualisation of legal rules, as coercive and authoritative orders. This illustrates the mismatch between the implicit assumptions about how law is expected to matter and the empirical procedure used to test whether law matters which Schiehl and Martins (2016) refer to.

If we do take the coercive view of law seriously, we would have to test the following proposition:

⁹ However, arguably Mario Draghi – the main sponsor of the Draghi law – was himself strongly influenced by the ADRI. One could hence expect that the changes brought about by that law is actually captured very well by this index. Or rather conversely: the law reflects the ADRI.

P1: Controlling for other factors, an increase in legal shareholder protection will only lead to an increase in the degree of shareholder-orientation in those practices that are directly targeted by the reform.

The coercive view is only weakly supported by empirical evidence. Thus, Mengoli et al. (2009: 639), in a study on Italian legal reforms find that institutional investors were reluctant to use litigation to enforce new legal shareholder rights, which has limited the impact of the reform (similarly Enriques & Volpin 2007). This is from their (implicitly) coercive view of law a surprising finding (Mengoli et al. 2009). Importantly, it raises the question of what remains of the effect of law on companies if the threat of legal consequences becomes an implausible driver of change due to investors reluctance to use it. The coercive view of law cannot explain how law would matter in such a situation.

Using general measures of legal shareholder protection which do not capture the firm-level practices that are being investigated is not necessarily an absurd way of proceeding; it does imply, however, a different mechanism linking the law to corporate outcomes than the coercive view. Here, the suggested link between law and corporate outcomes is – contrary to the coercive concept of law – not a direct one, as the legal measure does not contain any information about the legality or otherwise of the practices that are being investigated. Rather, most empirical studies implicitly suggest only indirect ways in which legal factors impact corporate governance outcomes.

Based on the normative signalling perspective, one could argue that an increase in the ADRI may *signal* to companies that minority shareholder protection is an important issue and protecting shareholders is *appropriate* behaviour. From this perspective of the “normativity of law”, we would expect that legal reform would impact corporate governance practices at the firm level even if a given practice is not explicitly targeted by the reform. This is because the legal change may signal in broad terms that a new norm such as “shareholder value” has become accepted and practices going against this norm are considered inappropriate even when they are legal. In this case, we would posit the following proposition:

P2: An increase in legal shareholder protection is associated with an increase in shareholder-orientation of corporate governance practices even in areas that are not targeted by any specific legal provisions.

However, many studies suggest that the main reason why the level of MSP is expected to impact on firm level practices is incentives. Thus, Cuomo et al.’s (2012) study of the use of control enhancing mechanisms (CEMs) is based on the assumption that the better legal shareholder protection, the more difficult it is for insiders to extract large amounts of private benefits of control (PBCs). Therefore, the *incentives* to stick with CEMs are reduced independently of whether these CEMs are indeed targeted by the law

or not. LLSV (2000:6) too focus on incentives by referring to “expropriation technologies”: “At the extreme of no investor protection, the insiders can steal a firm’s profits perfectly efficiently. [...] As investor protection improves, the insiders must engage in more distorted and wasteful diversion practices such as setting up intermediary companies into which they channel profits. [...] When investor protection is very good, the most the insiders can do is overpay themselves, put relatives in management, and undertake some wasteful projects. [...] As the diversion technology becomes less efficient, the insiders expropriate less, and their private benefits of control diminish.¹⁰” This reduces the incentives to stick with such corporate governance mechanisms. In order to distinguish this incentive perspective from the coercive- and the normative perspectives we can formulate the following proposition referring to the level of PBCs:

P3: Legal change in shareholder protection that is not directly target at a given corporate practice will have a stronger impact on change in such practices when private benefits of control are high.

The operationalisation of these propositions into testable hypothesis is certainly not easy. Indeed, the granularity of data needed in order to investigate the quite subtle differences among the mechanisms that these propositions postulate may be a practical challenge. Nevertheless, as Schiehl and Martins (2016: 195) state “methodological design issues need to be addressed in order to improve our understanding of the interplay between country- and firm-level governance mechanisms and the effects on firm outcomes.” The propositions presented in this section can provide a basis for designing more rigorous tests of the impact of law on corporate governance outcomes than is often the case currently.

6. Conclusion

This paper provided a comprehensive review of 20 years of Law and Finance scholarship in order to determine what concept(s) of law informs the core studies in this field. The surprising conclusion of the literature review was that the LFS – in spite of the fact that bringing law back into the comparative corporate governance research –actually has very little to say about what law is and how it affects economic actors and outcomes.

¹⁰ Implicitly, the LFS concept of law does acknowledge the importance of incentives, although they are only considered in relation with the threat of coercion. Thus, as mentioned in section 2, the link between legal shareholder protection and ownership concentration is explicitly conceptualised based on incentives: Increasing protection of property rights means that investors do not have to fear expropriation by insiders, which incentivises shareholders to abandon large controlling stakes in favour of more diversified portfolios with minority positions in many firms. Also, the more recent LFS studies – in particular those in the legal realist paradigm – closely look at the incentives that judges have to either favour shareholders or their own career interests (Glaeser et al. 2001). However, the LFS does not consider incentives as a direct means for law to influence behaviours. Indeed, law can actively create incentives – other than threat of punishment –, e.g. by increasing the costs of certain types of behaviours through legal rules (e.g. smoking) (cf. Green 2012). LFS neglects this aspect of law.

Indeed, the LFS seems mainly to be an attempt to apply economic theory and econometric methods to legal phenomena rather than the other way round. The literature review does reveal certain recurring themes that constitute an embryo of legal theory in the LFS: Much of the LFS literature suggests that law mainly matters through its function of protecting property rights and it deploys its effect on economic actors through the threats of punishment that stem from the enforcement of law. Indeed, the importance associated to enforcement issues in the LFS literature hints at the underlying command theory of law and a proximity with legal realism. Yet, the legal theory underlying LFS is tentative, underdeveloped, and at times contradictory.

More importantly, and possibly partly as a result of the failure to develop a clearer theoretical explanation of how law matters – the LFS seems to have increasingly abandoned the enterprise of establishing how substantive characteristics of laws influence firm-level and economy-level outcomes. Instead, the field has moved into two different and quite unrelated directions: for one, and from very early on, the LFS has shifted towards investigating increasingly broad cultural and political factors – such as legal origins and judicial independence. For the other, an increasingly legal realist approach has led authors associated with the LFS to zero in on what judges do in courts rather than on broad country-level legal characteristics. This paper has argued that we should not abandon the goal of investigating how law matters so, but rather we should take legal factors seriously and turn to legal theory for a better theoretical grounding of the issue.

The paper discussed alternative theories and attempted to go beyond the basic functions of property rights protection and incentive creation. It argued that the normativity of law has been neglected in the LFS literature. If, as legal scholarship suggests, laws impact behaviours not only through threats and incentives, but also through normative signals, existing tests of the law matters hypothesis may be flawed, as they do not capture all the potential impacts law has on corporate practices. Indeed, the neglect of certain functions and impacts of law on economic outcomes may affect the accuracy and validity of empirical findings from studies in this area (Schiehll & Martins 2016). In other words, in order to answer accurately the question “does law matter?” this paper suggests that we first need to tackle the question “how do we expect law to matter?” It is hoped that the paper provides a useful first step in guiding empirical research into these questions into new, more promising directions. More work needs to be done on empirical research designs, which allow scholars to better capture the subtleties and complexity of the link between law and corporate practices. Here, innovative research designs and methods may prove particularly fruitful.

References:

- Aguilera, R. , Desender, K., Bednar, M. , & Lee, J. (2015). "Connecting the dots: Bringing External Corporate Governance into the Corporate Governance Puzzle," The Academy of Management Annals, 9: 483–573.
- Aguilera, R. V. & Jackson, G. (2010). "Comparative and International Corporate Governance," The Academy of Management Annals, 4 (1): 485-556.
- Aguilera, R. and Jackson, G. (2003). "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants," Academy of Management Review 28(3): 447-465.
- Aguilera, R. and Williams, C. (2009). "'Law and Finance': Inaccurate, Incomplete, and Important," Brigham Young University Law Review 2009(6): 1413-1434
- Armour, J., Deakin S., Sarkar P., Siems M., and Singh A. (2009a). "How do legal rules evolve? Evidence from a cross-country comparison of shareholder, creditor and worker protection." CBR Working Paper 382.
- Armour, J. Deakin S., Sarkar P., Siems M., and Singh A. (2007). "Shareholder protection and stock market development: an empirical test of the legal origin hypothesis," Journal of Empirical Legal Studies, 6(2): 343-380.
- Austin, J. (1832). The Province of Jurisprudence Determined. London: John Murray.
- Beck, T., R. Levine, N. Lozyza. (2000). "Finance and the Sources of Growth", Journal of Financial Economics, 58: 261-300.
- Beck T., Demirgüç-Kunt A. and Levine R. (2005). "Law and Firms' Access to Finance", American Law and Economics Review 7(1): 211-252
- Beck T., Demirgüç-Kunt A. and Levine R. (2003a). "Law and finance: why does legal origin matter?," Journal of Comparative Economics, 31: 653-675.
- Becker, G. (1968). "Crime and Punishment: An Economic Approach," Journal of Political Economy, 76(2): 169-217.
- Bentham, J. (1843) "Anarchical Fallacies; Being An Examination of the Declarations of Rights Issued During the French Revolution By Jeremy Bentham", in The Works of Jeremy Bentham J.Bowring (ed.), 184 [available online at: http://english.duke.edu/uploads/media_items/bentham-anarchical-fallacies.original.pdf ; last visited 21.4.2016]
- Berkowitz, D., et al. (2003). "Economic development, legality, and the transplant effect." European Economic Review 47: 165-195.

- Cheffins, B. R. (2001). "Does Law Matter? The Separation of Ownership and Control in the United Kingdom." Journal of Legal Studies **30**.
- Chemmanur, T. J. and P. Fulghieri (2006). "Competition and cooperation among exchanges: a theory of cross-listing and endogenous listing standards." Journal of Financial Economics **82**: 455-489.
- Chong, A., R. La Porta, F. Lopez-de-Silanes, A. Shleifer. 2014. "Letter Grading Government Efficiency," Journal of the European Economic Association, 12(2): 277-299.
- Claessens, S. and L. Laeven (2003). "Financial Development, Property Rights, and Growth." the Journal of Finance **58**(6): 2401-2436.
- Commons, J. (1924) Legal Foundations of Capitalism (New York: Macmillan).
- Coase, R. (1960). "The Problem of Social Cost," Journal of Law and Economics, **3**: 1-44,
- Coffee, J. C. (2000). "The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control." Columbia Law and Economics Working Paper **182**: 1-95.
- Coffee, J. (2001). "Do Norms Matter? A Cross-country Evaluation," University of Pennsylvania Law Review, **149**: 2151-2177.
- Cuomo, F., et al. (2012). "The effects of legal reforms on the ownership structure of listed companies." Industrial and Corporate Change **22**(2): 427-458.
- Dam, Kenneth. (2006) *The Law-Growth Nexus: The Rule of Law and Economic Development*, Washington DC: Brookings Institution Press.
- Damaska, M. (1986). *The Faces of Justice and State Authority: A Comparative Approach to the Legal Process*, New Haven, Yale University Press.
- Deakin, S., Gindis, D., Hodgson, G., Huang, K. & Pistor, K. (2015). Legal Institutionalism: Capitalism and the Constitutive Role of Law. *CBR Working Paper*, 1-40.
- Deakin, S., et al. (2011). "An End to Consensus? The Selective Impact of Corporate Law Reform on Financial Development." CBR Working Paper **423**: 1-33.
- Djankov, S. R. La Porta, F. Lopez-de-Silanes, A. Shleifer. (2010). "Disclosure by Politicians," American Economic Journal: Applied Economics **2**:179-209.
- Djankov, S., et al. (2008). "The Law and Economics of Self-Dealing." Journal of Financial Economics **88**(3): 430-465.
- Djankov, S., C. McLiesh, and A. Shleifer.(2007). "Private Credit in 129 Countries", Journal

of Financial Economics 12 (2): 77-99.

- Djankov, S., E. Glaeser, R. La Porta, F. Lopez-de-Silanes, and A. Shleifer. (2003a). "The New Comparative Economics." Journal of Comparative Economics , 31(4): 595-619.
- Djankov, S., R. La Porta, F. Lopezde- Silanes, and A. Shleifer. (2003b). "Courts." Quarterly Journal of Economics , 118(2): 453–517.
- Dworkin, R. (1988). *Law's Empire*, Harvard, Harvard University Press.
- Dworkin, R. (1997[1977]). *Taking Rights Seriously*, London, Bloomsbury Academic.
- Easterbrook, F. & Fischel, D. R. (1991). *The Economic Structure of Corporate Law*, Harvard, Harvard University Press.
- Enriques, L., & Volpin, P. 2007. Corporate Governance Reforms in Continental Europe. Journal of Economic Perspectives, 21(1): 117-140.
- Espen Eckbo, B. (2005). Strong insiders invite weak governance. Financial Times. (19 May 2005), London, Pearson.
- Fama, E. (1980). "Agency Problems and the Theory of the Firm". Journal of Political Economy, 88, 288-307.
- Finnis, J. (2011[1980]). Natural Law and Natural Rights, Oxford, Oxford University Press.
- Friedman, M. (1966[1953]). The Methodology of Positive Economics. Essays in Positive Economics. M. Friedman. Chicago, University of Chicago Press: 3-43.
- Fuller, L. (1969). The Morality of Law, Yale, Yale University Press.
- Furubotn, E. & S. Pejovich. (1972). "Property Rights and Economic Theory: A Survey of Recent Literature". Journal of Economic Literature, 10, 1137-62.
- Gennaioli, N. & A. Shleifer. (2007a). "Overruling and the Instability of Law." Journal of Comparative Economics 35 (2): 309-328.
- Gennaioli, N. & A. Shleifer (2007b) "The Evolution of Common Law." Journal of Political Economy 115(1): 43-68.
- Gennaioli, N. & A. Shleifer. (2008). "Judicial Fact Discretion," Journal of Legal Studies 37(1): 1-35.
- Gennaioli, N., R. La Porta, F. Lopez-de-Silanes & A. Shleifer. (2014). "Growth in Regions" Journal of Economic Growth 19: 259-309.

- Gamble, A. (2013). "Hayek and Liberty", Critical Review **25**(3-4): 342-363.
- Gilson, R. J. (2005). "Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy." European Corporate Governance Institute Working Paper **49**: 1-53.
- Gilson, R. J. (2004). "Globalizing corporate governance: convergence of form or function." In Convergence or Persistence of Corporate Governance. J. N. Gordon and M. J. Roe. Cambridge, Cambridge University Press: 128-159.
- Glaeser, Edward L., Rafael La Porta, Florencio Lopezde- Silanes, and Andrei Shleifer. 2004. "Do Institutions Cause Growth?" Journal of Economic Growth , 9(3): 271–303.
- Glaeser, E. Scheinkman, J., and A. Shleifer. (2003). "The Injustice of Inequality", Journal of Monetary Economics 50: 199-222.
- Glaeser, E. & A. Shleifer. (2003) "The Rise of the Regulatory State", Journal of Economic Literature 41 (2): 401-425.
- Glaeser, E. & A. Shleifer. 2002. "Legal Origins". The Quarterly Journal of Economics, 117: 1193-1229.
- Gordon, J. N. and M. J. Roe, Eds. (2004). Convergence and Persistence in Corporate Governance. Cambridge, Cambridge Univ. Press.
- Gourevitch, P. A. and J. Shinn (2005). Political Power & Corporate Control. The New Global Politics of Corporate Governance. Princeton, Princeton University Press.
- Green, L. (2015). "The Forces of Law: Duty, Coercion and Power," Legal Research Paper Series. University of Oxford, 12/2015: 1-34.
- Green, L. (2013). "Should Law Improve Morality?" Criminal Law and Philosophy, **7**:473-494.
- Green, L. (2012[1961]). "Introduction". In: HART, H. L. A. (ed.) The Concept of Law. Third edition ed. Oxford: Oxford University Press.
- Green, M. (2005). "Legal Realism as Theory of Law," William & Mary Law Review 46(6): 1915-2000.
- Grossman, S., and O. Hart. (1988). "One Share–One Vote and the Market for Corporate Control." Journal of Financial Economics, 20(1–2):175–202.

- Hansmann, H. and R. Kraakman (2004). "The End of History for Corporate Law." In Convergence and Persistence in Corporate Governance. J. N. Gordon and M. J. Roe. Cambridge, Cambridge University Press: 33-68.
- Hart, O. 1995. Firms, Contracts, and Financial Structure. Oxford and New York: Oxford University Press, Clarendon Press.
- Hart, H. (2012[1961]). The Concept of Law, Oxford, Oxford University Press.
- Hay, J. & Shleifer, A. (1998). "Private Enforcement of Public Laws: a Theory of Legal Reform." American Economic Review Papers and Proceedings, **88**: 398-403.
- Hayek, F. (2013[1982]). Law, Legislation and Liberty, London: Routledge.
- Hayek, F. (2011[1960]). The Constitution of Liberty. The definitive edition, (ed. Hamowy, R.), The Collected Works of F. A. Hayek Volum XVII. Chicago: University of Chicago Press.
- Himma, K. (2002). "Substance and Method in Conceptual Jurisprudence and Legal Theory," Virginia Law Review, 88(5): 1119-1228.
- Himma, K. (no date). "Natural Law," Internet Encyclopedia of Philosophy, available at <http://www.iep.utm.edu/natlaw/#H3> [last visited: 19/07/2016]
- Holmes, O. (1897). "The Path of the Law", Boston Law School Magazine, 1(4): 1-18.
- Jackson, G. & R. Deeg. (2008). "Comparing Capitalisms: Understanding institutional diversity and its implications for international business," Journal of International Business Studies, 39: 540-561.
- Jensen, Michael C., and William H. Meckling. 1976. "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," Journal of Financial Economics, 3(4): 305-60.
- Johnson, S., R. La Porta, F. Lopez-de-Silanes, A. Shleifer. (2000a). "Tunneling," American Economic Review, 90(2): 22-27.
- Johnson, S, P. Boone, A. Breach, E. Friedman. (2000b). "Corporate Governance in the Asian Financial Crisis", Journal of Financial Economics **58**: 141-186.
- Jolls, C. 2007. Behavioral Law and Economics. NBER Working Paper, 12879: 1-47.
- Kelsen, H. 1967. The Pure Theory of Law. Berkeley: University of California Press.
- Lan, L. and L. Heracleous. (2010). "Rethinking Agency Theory: The View from Law", Academy of Management Review **35**(2): 294-314.

- La Porta, R. & A. Shleifer. (2014). "Informality," Journal of Economic Perspectives, **28**(3): 109-26.
- La Porta, R. & A. Shleifer. (2009). "Divergence of Legal Procedures," American Economic Journal: Economic Policy, 1(2): 1-45.
- La Porta, R. & A. Shleifer. (2008). "The Unofficial Economy and Economic Development", Brookings Papers on Economic Activity 1-65.
- La Porta, R., F. Lopez-de-Silanes, A. Shleifer and R. Vishny. (1997a). "Legal Determinants of External Finance." the Journal of Finance **52**(3): 1131-1150.
- LLSV (1997b). "Trust in Large Organizations," AEA Papers and Proceedings, **87**(2): 333-338.
- LLSV (1998). "Law and Finance." Journal of Political Economy **106**(6): 1113-1155.
- LLSV (1999). "The Quality of Government," Journal of Law, Economics and Organization, 15(1): 222-279.
- LLSV (2000a). "Investor protection and Corporate Governance," Journal of Financial Economics, **58**:3-27.
- LLSV (2000b). "Agency Problems and Dividend Policies around the World," Journal of Finance, 55(1): 1-33.
- La Porta, R., F. Lopez-de-Silanes, C. Pop-Eleches, & A. Shleifer. (2004). "Judicial Checks & Balances", Journal of Political Economy, **112**(2): 445-470.
- LLS (2006). "What Works in Securities Laws?" Journal of Finance, 61(1): 1-32.
- LLS (1999). "Corporate Ownership Around the World," Journal of Finance 54(2): 471-517
- Larsson-Olaison, U. 2014. Convergence of National Corporate Governance Systems: Localizing and Fitting the Transplants. Växjö: Linnaeus University Press.
- Levine, R. (2005). "Law, Endowments and Property Rights", Journal of Economic Perspectives, **19**(3): 61-88.
- Levine, R. (1999). "Law, Finance, and Economic Growth", Journal of Financial Intermediation, **8**: 8-35.
- Lindenberg, S. (2013). "Cognition and governance: why incentives have to take a back seat" (pp. 41-61). In: A. Grandori (ed.), Handbook of Economic Organization. Integrating Economic and Organization Theory. Cheltenham: Elgar

- Lueck, D. & Miceli, T. (2007). "Property Law." *In*: Polinsky, A. M. & Shavell, S. (eds.) Handbook of Law and Economics. Amsterdam: North-Holland.
- Mahoney, P. (2001). "The Common Law and Economic Growth: Hayek Might Be Right," The Journal of Legal Studies, **30**(2): 503-525
- Mengoli, S., Pazzaglia, F., & Sapienza, E. 2009. Effect of Governance Reforms on Corporate Ownership in Italy: Is It Still Pizza, Spaghetti, and Mandolino? Corporate Governance: An International Review, **17**(5): 629-645.
- Milhaupt, C. J. and K. Pistor (2008). Law & Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World. Chicago, Chicago University Press.
- Moore, M. (2000). Educating Oneself in Public. Critical Essays in Jurisprudence, Oxford: Oxford University Press.
- Moore, M. (1992). Law as a Functional Kind. *In*: GEORGE, R. P. (ed.) *Natural Law Theory: Contemporary Essays*. Oxford: Oxford University Press.
- Ogus, A. (1989). "Law and Spontaneous Order: Hayek's Contribution to Legal Theory," The Journal of Law and Society 16(4): 393-409.
- Ohnesorge, J. (2007). "The Rule of Law." Annual Review of Law and Social Science **3**: 99-114.
- Ohnesorge, J. (2009). "Legal Origins and the Tasks of Corporate Law in Economic Development: A Preliminary Exploration," Brigham Young University Law Review, **2009**(6): 1619-1634.
- Pagano, M. and P. F. Volpin (2005). "The Political Economy of Corporate Governance." American Economic Review **95**(4): 1005-1030.
- Peng, M., Wang, D., & Jiang, Y. 2008. An institutionbased view of international business strategy: A focus on emerging economies. Journal of International Business Studies, 39(5): 920–936.
- Peng, M. W., Sun, S. L., Pinkham, B., & Chen, H. 2009. The Institution-based view as a Third Leg for a Strategy Tripod. Academy of Management Perspectives, 23(3): 63-81.
- Perry, S. (2006). "Hart on Social Rules and the Foundations of Law: Liberating the Internal Point of View" University of Pennsylvania Law School Faculty Scholarship. (2006): 1107-1209.
- Posner, Richard. (1993). "New Institutional Economics Meets Law and Economics," Journal of Institutional and Theoretical Economics 149(1): 73-87.

- Posner, Richard. (1973). Economic Analysis of Law. Boston: Little-Brown.
- Priest, G. (1977) "The Common Law Process and the Selection of Efficient Rules," Journal of Legal Studies 6(1): 65-82.
- Raz, J. (2009). Between Authority and Interpretation. Oxford: Oxford University Press.
- Robinson, P. & Darley, J. (2007). "Intuitions of Justice: Implications for Criminal Law and Justice Policy," Southern California Law Review 81: 1ff.
- Roe, M. (2006). "Legal Origins, Politics, and Modern Stock Markets" Harvard Law Review 120(2): 460-527.
- Roe, M. and J. Siegel. (2009) "Finance and Politics: A Review Essay Based on Kenneth Dam's Analysis of Legal Traditions in *The Law-Growth Nexus*", Journal of Economic Literature, 47(3): 781-800.
- Sarat A. and Kearns T. (eds). (1993), Law in Everyday Life. Ann Arbor: University of Michigan Press.
- Schiehll, E. & H. Martins. (2016). "Cross-National Governance Research: A Systematic Review and Assessment," Corporate Governance: An International Review, 24(3): 181-199.
- Schauer, F. (2014). The Force of Law Cambridge, Mass: Harvard University Press.
- Schnyder, G. (2012). "Measuring Corporate Governance: Lessons from the 'Bundles Approach'" Centre for Business Research Working Paper 438: 1-39.
- Scott, W. R. 1995. Institutions and Organizations. Thousand Oaks: Sage.
- Scott, W. R. 2008. "Approaching Adulthood: The Maturing of Institutional Theory". Theory and Society, 37(5): 427-442.
- Shapiro, S. J. (2011). Legality. Cambridge, MA: Belknap Press.
- Shleifer, A. (2005). "Understanding Regulation," European Financial Management 11 (4): 439-451.
- Shleifer, A. and R. W. Vishny (1997). "A Survey of Corporate Governance." the Journal of Finance 52(2): 737-783.
- Siems, M. M., et al. (2009). CBR Extended Shareholder Protection Index. Cambridge, Centre for Business Research: 1-105.
- Siems, M. 2007. Reconciling Law & Finance and Comparative Law. McGill Law Journal, 52, 55-81.

- Siems, M. (2005). What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al's Methodology, International Company and Commercial Law Review, pp.300-305.
- Singh, A. (2011). "Comparative advantage, industrial policy and the World Bank: back to first principles." Policy Studies **32**(4): 447-460.
- Spamann, H. (2010). "The "Anti-Directors Rights Index" Revisited," Review of Financial Studies **23**(2): 467-486.
- Stigler, George J., "Public Regulation of the Securities Market," *Journal of Business*, 37:117–142.
- Sunstein, C. R. 1996. On the Expressive Function of Law. University of Pennsylvania Law Review, 144: 2021-2053.
- Teubner, G. 2001. Legal Irritants: How Unifying Law Ends up in New Divergences. In: HALL, P. A. & SOSKICE, D. (eds.) *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage*. Oxford: Oxford University Press.
- Teubner, G. (1983). "Substantive and Reflexive Elements in Modern Law," Law & Society Review, 17(2): 239-285.
- Van Oosterhout, J., P. Heugens, and M. Kaptein (2006). "The Internal Morality of Contracting: Advancing the Contractualist Endeavor in Business Ethics", Academy of Management Review, 31(3): 521-539.
- Williamson, O. E. 1985. The economic institutions of capitalism: Firms, markets, relational contracting. New York: Free Press.
- Zweigert, K. & Kotz, H. 1998. *An Introduction to Comparative Law*, Oxford, Oxford University Press.

		1st Dimension: Nature and function of law		2nd Dimension: Law and its content		3rd Dimension: Effect
	Key Authors	Importance and primary function of legal rules in the economy	Source of authority/criterion for validity	Relationship between law and morals	Definition of good law	Law-takers motivation to obey the law
Natural Law Theory	John Finnis	Important for human society (specificity, clarity, predictability) and property rights	God/nature	Moral standards as criteria for moral validity of positive law	<u>Substantive</u> : Congruence with natural law	<u>Objective</u> : Practical reason/moral obligation to obey the law
Exclusive (Strong) Legal Positivism	J. Austin H. Kelsen	Commands important for guiding behavior/settling disputes/exercising control	Sovereignty Basic Rule (<i>Grundnorm</i>)	Separate	None	<u>Subjective</u> : Habit of obedience/ Fear of sanction
Inclusive (Weak) Legal Positivism	H. L. A. Hart	Legal rules important for guiding behavior/settling disputes/exercising control	Social Rule of Recognition	Separate	<u>Procedural</u> : Acceptance	<u>Objective</u> : Normativity of law
Legal Realism	O. W. Holmes K. Llewellyn J. Frank	Legal rules unimportant (rule-skepticism) – adjudication and its anticipation important to avoid socially undesirable outcomes	Judges’ decisions	Separate	None	<u>Subjective</u> : Fear of sanction imposed by courts (cost-benefit calculation)
Spontaneous Order (Functional-Evolutionary) Theory of Law	F. A. Hayek	Important for protection of individual (economic and political) liberty	Tradition Efficiency (as measured by survival)	Law ought to be based on historically grown community standards	<u>Meta-legal requirements</u> : Generality Universality Known Certain <u>Substantive</u> : Negativity Market-supporting	<u>Subjective</u> : Habit of obedience & Tradition Coercion in the last instance
Law & Finance School	LLSV	Important for protection of property rights	Efficiency of outcomes	Law ought to be based on community standards	<u>Substantive</u> : Protecting property rights/favoring trade/economic growth <u>Procedural</u> : Enforceability	<u>Subjective</u> : Fear of sanction (cost-benefit calculation)

Table 2: The Law & Finance School: Core Studies Analysed for this Paper			
Year	Authors	Reference	Legal variable of interest
1997	La Porta, R., F. Lopez-de-Silanes, A. Shleifer, & R. Vishny,(LLSV)	"Legal Determinants of External Finance", Journal of Finance (JoF), 52(3): 1131-1150	Anti-director rights index (ADRI) Legal origin (LO) (used as instrument variable)
	LLSV	"Trust in Large Organisations", AEA Papers and Proceedings, 87(2): 333-338	Efficiency of judiciary (control)
1998	LLSV	"Law and Finance", Journal of Political Economy (JPE), 1006(6): 1113-1155.	ADRI LO (instrument variable)
	Hay, J. & A. Shleifer	"Private Enforcement of Public Laws: a Theory of Legal Reform", AEA Review Papers and Proceedings, 88, 398-403.	Legal reform: what facilitates private enforcement of public rules?
1999	LLSV	"The Quality of Government," Journal of Law, Economics and Organization, 15(1): 222-279.	LO (used as a proxy for political system (interventionism) alongside a second political variable (ethno-linguistic heterogeneity)
	LLS	"Corporate Ownership Around the World," JoF 54(2): 471-517	ADRI LO (instrument variable)
	Levine, R.	"Law, Finance, and Economic Growth", Journal of Financial Intermediation, 8: 8-35.	LO Creditor rights Efficiency of the legal system in enforcing contracts Accounting standards
2000	LLSV	"Investor protection and Corporate Governance", Journal of Financial Economics (JFE), 58: 3-27.	Shareholder & Creditor protection
	Johnson, S, La Porta, R., F. López-de-Silanes, A. Shleifer, & R. Vishny	"Tunnelling," American Economic Review (AER), 90(2): 22-27	Use of general legal principles in court: Duty of care Duty of loyalty
	Johnson, S, Boone, P., Breach, A., Friedman, E.	Corporate Governance in the Asian Financial Crisis, JoFE, 58: 141-186	ADRI RoL
	LLSV	"Agency Problems and Dividend Policies Around the World", JoF, 55(1): 1-33.	Investor protection: Dummy based on ADRI sample median
	Beck, T., R. Levine, N. Lozyza.	"Finance and the Sources of Growth", JFE, 58: 261-300	LO
2001	Mahoney, P. G.	"The Common Law and Economic Growth: Hayek Might Be Right," The Journal of Legal Studies (JLS), 30(2): 503-525	LO
	Glaeser, E, S. Johnson & A. Shleifer	"Coase versus the Coasians", The Quarterly Journal of Economics (QJE) (2001) 116 (3): 853-899.	Type of contract/law enforcement regime (court based vs. public regulator)
2002	Djankov, S., La Porta, R., Lopes-de-Silanes, F., and Shleifer, A.	"The Regulation of Entry," QJE, 117: 1-37.	Entry regulation: Number of procedures Min. time and min cost to establish a business LO

	LLSV	"Investor Protection and Corporate Valuation" JoF 57(3): 1147-1170.	ADRI LO
	LLS	"Government Ownership of Banks", JoF, 57(1): 265-301.	ADRI LO (proxy for state intervention) RoL
	Shleifer, A. & D. Wolfenzon	"Investor Protection and Equity Markets", JFE 66 (1): 3-27.	Investor protection measured: Likelihood of punishment
	Glaeser, E. & A. Shleifer	"Legal Origins", QJE 117 (4): 1193-1229.	Extent of centralization of sovereign control over judiciary
2003	Djankov, S., E. Glaeser, R. La Porta, F. Lopez-de-Silanes, & A. Shleifer	The New Comparative Economics, Journal of Comparative Economics (JCE), 31(4), 595-619.	'Disorder' (expropriation by 'neighbours') v. 'dictatorship' (expropriation by government) trade-off
	Djankov, S, R. La Porta, F. López-de-Silanes, & A. Shleifer	"Courts: The LEx Mundi Project," QJE 118(2): 453-517.	Legal formalism (in eviction procedures and in collection of bounced checks)
	Glaeser, E., & A. Shleifer	"The Rise of the Regulatory State", Journal of Economic Literature (JEL) 41 (2): 401-425.	Type of law enforcement regime: i. Private litigation ii. Gvt regulation iii. Combination of i and ii iv. Do nothing
	Glaeser, E., J. Scheinkman, & A. Shleifer	"The Injustice of Inequality" Journal of Monetary Economics 50 (1): 199-222.	Subversion of institutions (courts) Aspects of LO: Judicial independence, judicial review
	Beck, T., A. Demirguc-Kunt, & R. Levine	"Law and Finance: Why does Legal Origin Matter?" JCE 31: 653-675.	Aspects of LO: Adaptability of legal system Political independence of the judiciary
2004	Glaeser, E., R. LaPorta, F. Lopez-de-Silanes, & A. Shleifer	"Do institutions cause growth?" Journal of Economic Growth (JEG) 9: 271-303	Polity's constraints on executive power LO
	Botero J., S. Djankov, R. La Porta, F. Lopez-de-Silanes & A. Shleifer	"The Regulation of Labor," QJE, 119: 1340-1382.	Labour regulations LO
	La Porta, R., F. Lopez-de-Silanes, C. Pop-Eleches, & A. Shleifer	"Judicial Checks & Balances", JPE, 112(2): 445-470.	Judicial independence and constitutional review LO
2005	Mulligan, C., & A. Shleifer	"The Extent of the Market and the Supply of Regulation." QJE 120 (4): 1445-1473	Regulatory density (number of pages of regulation in different US states)
	Shleifer, A.	"Understanding Regulation." European Financial Management 11 (4): 439-451.	Enforcement theory of regulation choice: Tradeoff between disorder and

			dictatorship
	Beck, T., Demirguc-Kunt, A. & Levine, R.	"Law and Firms' Access to Finance", American Law and Economics Review 7(1): 211-252	Aspects of LO : Adaptability of legal system Political independence of the judiciary
	Levine, R.	"Law, Endowments and Property Rights", Journal of Economic Perspectives (JEP), 19(3): 61-88.	Protection of property rights LO
2006	La Porta, R., F. Lopez-de-Silanes & A. Shleifer	2006. "What works in securities laws?" JoF 61: 1-33.	Security law rules: prospectus disclosure, liabilities etc
2007	Gennaioli, N. & A. Shleifer	"Overruling and the Instability of Law." JCE 35 (2): 309-328.	"Overruling" as one mechanism of revising precedents under common law
	Gennaioli, N. & A. Shleifer	"The Evolution of Common Law." JPE 115 (1): 43-68.	"Distinguishing" a mechanism of revising precedents under common law
	Djankov, S., C. McLiesh, and A. Shleifer.	"Private Credit in 129 Countries", JFE 12 (2): 77-99.	Legal creditor rights Private & public registries (information-sharing institutions) LO
2008	LLS	"The Economic Consequences of Legal Origins." JEL 46(2): 285-332.	Review paper LO ADRI
	Djankov, S., R. La Porta, F. Lopez-de-Silanes & A. Shleifer	The Law and Economics of self-dealing JFE 88 (2008) 430-465	Anti-Self-dealing Index (ASDI)
	La Porta, R. & A. Shleifer	"The Unofficial Economy and Economic Development", Brookings Papers on Economic Activity: 1-65.	RoL Cost of complying with labour laws
	Djankov, S., O. Hart, C. McLiesh, & A. Shleifer	"Debt Enforcement around the World" JPE 116 (6): 1105-1150.	Measure of efficiency of debt enforcement (case: bankruptcy of a hotel) LO
	Gennaioli, N., & A. Shleifer	"Judicial Fact Discretion," JLS 37 (1): 1-35.	Judicial discretion in fact finding
2009	Balas, A., R. La Porta, F. Lopez-de-Silanes, & A. Shleifer	"The Divergence of Legal Procedures" American Economic Journal: Economic Policy, 1(2): 1-45.	Formalism of legal procedure (Djankov et al. 2003 extended to a 1950-2000 period)
2010	Aghion, P., Y. Algan, P. Cahuc, and A. Shleifer.	"Regulation and Distrust," QJE 125 (3): 1015-1049.	Determinants of demand for regulation
	Niblett, A., R. Posner & A. Shleifer.	"The Evolution of a Legal Rule." "The Evolution of a Legal Rule," JLS 39(2): 325-358	Evolution towards efficiency of legal rule (economic loss rule, ELR)
2014	La Porta, R. & A. Shleifer	"Informality," JEP, 28(3): 109-26.	RoL Cost of complying with labour laws
	Gennaioli, N., R. La Porta, F. Lopez-de-	"Growth in Regions" JEG 19: 259-309.	Legal/regulatory barriers to factor mobility across

	Silanes & A. Shleifer		regions LO (control)
2015	Bordalo, P., N. Gennaioli, and A. Shleifer	"Salience Theory of Judicial Decisions," JLS, 44(1): S7-S33	Judicial decisions (decision-making biases – notably salience)