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This comment connects Gerner-Beuerle's article on the evolution of company and securities law to the 'law and finance school', exploring the problems of original 'law and finance' research, Gerner-Beuerle's contribution in this direction, and suggesting how and why we may need a 'time traveller's guide' to law and finance.


The article by Carsten Gerner-Beuerle compares Germany and the UK in relation to the evolution of company and securities law in the 19th and early 20th century. In addition, the article makes the original contribution that it contextualises this research on corporate legal history by way of exploring the reasons that explain the legal evolution and divergent development of financial markets in both countries.

These latter aspects connect the article to the line of research on ‘law and finance’, recently also called the ‘law and finance school’. The main proponents of this research only feature briefly in Gerner-Beuerle's article, yet, as will be shown in the following, its relevance is clearly present in many of the article's core findings. Thus, the main aim of this MLR Forum comment is not to scrutinise the details of German and UK law (which are thoroughly explained in the article); rather, the focus will be on (i) the problems of the mainly static nature of the original 'law and finance' research, (ii) the contributions of Gerner-Beuerle's article to this line of research, and (iii) the wider research context that may point towards the need for a 'time traveller's guide to law and finance'.

(i) Research on ‘law and finance’ is today usually associated with research by Rafael La Porta and his co-authors – and the initial study from the late 1990s was indeed called ‘Law and Finance’. This study coded the law on shareholder and creditor protection across countries.
For instance, with respect to shareholder protection, it used six variables to construct an index for ‘anti-director rights’. Next, La Porta et al looked at forty-nine countries and calculated an aggregate score for the strength of ‘anti-director rights’ for each of the legal systems. They also grouped the countries into ‘legal origins’, with the result that common law countries had the strongest, and French civil law countries the weakest legal protection of shareholders. Finally, they drew on these numbers as independent variables for statistical regressions, finding that good shareholder protection leads to more dispersed shareholder ownership, which can be seen as an indicator for developed capital markets.

Many subsequent papers by La Porta and other researchers have used a similar method for other areas of law, for instance, in civil procedure, securities regulation, and labour law, and the World Bank has also incorporated some of these studies into its annual ‘Doing Business’ Reports.[4] This also includes questions of corporate disclosure and the ease of incorporation (and thus the topics of Gerner-Beuerle’s article). By and large, the findings of all of the ‘law and finance’ studies are similar, noting a common law advantage and finding confirmation of the claim that laws supportive of market-based economic activity ‘matter’ for the financial success of a country, for example, as they enhance the availability to firms of external finance.

On the one hand, the alleged result that there are significant differences between legal origins, means that the ‘law and finance’ studies claim that a country’s history has a profound effect. In particular this is noted for the former colonial countries: countries which inherited the common law model through the British colonial empire have better laws than countries which inherited the civil law model through the colonial influence of continental European countries. On the other hand, the empirical results supporting the ‘law and finance’ claims rely entirely on cross-sectional regression analysis of the laws today. Thus, they are also ambiguous as to the direction of causality: while ‘good quality’ legal rules could enhance investment, it is also plausible that financial structure influences the creation of legal norms.[5]

(ii) The article by Gerner-Beuerle can be associated with the research which has identified methodological and substantive problems of these ‘law and finance’ studies.[6] To elaborate, Gerner-Beuerle’s historical-comparative-contextual findings point towards at least three problems with the conventional ‘law and finance’ findings.

First, as regards disclosure obligations of companies, the article identifies similar levels of protection in the UK and Germany for the period under investigation. In this regard, it also identifies the common trend that the disclosure and liability laws were not merely seen as a matter of private balancing but as constitutive for efficient capital markets. Thus, Gerner-Beuerle challenges the ‘law and finance’ notion of deep differences between a core common law country and a core civil law one for one of the core topics in this line of research.

Second, the article discusses what modalities and motivations of law makers and courts shape legal changes. These findings challenge the view of deep divides between civil and common law countries in terms of legal evolution and adaptability as presented in the ‘law and finance’ studies. Gerner-Beuerle shows that there is nothing inherent in common or civil law that makes one more susceptible to gradual evolution and adaptation in response to changing market forces than the other as the evolution of disclosure regulation and liability for incorrect disclosures in both Germany and the UK were gradual and ‘endogenous’. Also, the changes to the formation law in Germany do not seem to have much to do with the character of the legal system as common law or civil law, but it is a function of the specific, localised political and economic conditions at the time. In other words, this reform could have easily turned out differently, for example due to the political dynamics in the German parliament.
Third, the explicit background of the article by Gerner-Beuerle is that the UK had (and still has) a more developed financial market than Germany. Yet, in contrast to the law and finance view, it shows that this was not the result of weaker disclosure rules but may be related to the 1884 changes in the formation requirements. In this regard, it can therefore be interpreted as a nuanced answer to the question about the economic effect of legal rules: law can cause changes but there is no automatic process; rather it is necessary to understand the precise interaction between law, finance and politics.

(iii) These three points are important contributions to research on ‘law and finance’. In addition, they can be seen as part of the general aspiration to take time more seriously in this line of research. Thus, it can be suggested that, what is needed is, a ‘time traveller’s guide to law and finance’, considering developments in the past, present and future with both quantitative and qualitative methods.

Starting with the past, this is meant to refer to research which analyses the junctures that have led to diverging paths or other critical phenomena in the financial markets. As far as there is quantitative research, there has been some research which has extended the coding by ‘law and finance’ scholars to the early 20th century. Amongst others, the findings of these studies have challenged the view that features of the law seen as essential today were indeed necessary for the initial emergence of vibrant capital markets. Yet, applying the same coding template, say on investor protection, is problematic as market conditions change over time. Thus, what would be needed would be to develop a coding template sensitive to the factual and social circumstances of the past.

Alternatively, qualitative work is possible, as the article by Gerner-Beuerle shows. Prominent other research on the development of capital markets in the US and the UK has also challenged the ‘law matters’ claim. In both countries, capital markets and product markets alike experienced a transition from personal exchange based on interpersonal trust to impersonal transacting. There was also a shift from informal institutions to formal ones, which was accompanied by the shift from regional capital markets to integrated national ones. Legal rules providing investor protection emerged only at a later stage, after the rise of a broadly based investor class. According to this historical evidence, it was the rise of the capital market which prompted legal reforms, contrary to the direction of causation assumed by the ‘law and finance’ studies.

Turning to the present (including the more recent past), recent studies at Cambridge’s Centre for Business (CBR) have developed their own templates on shareholder, creditor and worker protection, coding the evolution of legal rules from the 1970s to the 2010s. Such longitudinal legal data have the advantage over the cross-sectional approach of the ‘law and finance’ studies that they may, in principle, be used to uncover the direction of the relationship between legal and financial data. Yet, it also needs to be acknowledged that the force of such comparative empirical legal studies will never be as ‘clean’ as scientific research since law reforms do not occur randomly in one country but not in others.

In detail, a key finding of the CBR studies is that different legal topics expose different dynamics — and thus also being in line with the differentiation by Gerner-Beuerle (in his case, the disclosure and formation requirements). For example, while the CBR studies find strong evidence of convergence in questions of shareholder protection, this is less so for creditor and worker protection. There is also an important divergence from the ‘law and finance’ studies in that they sometimes did not find a statistically significant effect of legal rules.
The qualitative work conducted at the CBR confirms this need for a nuanced assessment. A specific feature of these studies is that they are interested in countries that are emerging economies today. The interest in emerging economies is similar to the article by Gerner-Beuerle, but there are important differences as well. For example, if we analyse countries today the research methods are different as it is possible to do interviews with the participants of the legal and economic processes at stake (and of course there are also other factors that influence the process of research today, for instance, in terms of the ease of accessibility of legal and financial information).

It is also crucial to consider that legal reforms of today’s emerging economies are different from those of the emerging economies of Germany and UK in the past. Today, law reforms are often the results of legal transplants and therefore possibly of an exogenous nature. Indeed, while the findings of the ‘law and finance’ studies do not very well explain the financial development of early industrialisers, the role of formal institutions protecting investors might be more relevant to newly-established capital markets in today’s emerging countries. For example, unlike the situation in the former countries where stock markets evolved without direct state assistance from small regional markets into larger national exchanges, newly-established stock markets in many countries are consciously designed and imposed by the state. Given the lack of informal substitutes for state-designed institutions, it is then also possible that legal protection of investors is more likely to be a prerequisite to the development of stock markets.

Finally, a time-traveller is bound to be interested in the future. This relates the topic of ‘law and finance’ to the field of ‘law and development’ with its aim to identify what type of laws and institutions can stimulate finance, the economy as well as development more generally. This too may use quantitative methods such as tools of economic impact assessment, while more qualitative work has the advantage that it can reflect on the specific circumstances of the legal topic and country under consideration.

In addition, it is clear that both ‘law’ and ‘finance’ are moving targets. Today’s legal configurations are different from the past if we only think about the growing use of terms such as transnational legal orders, global law, governance indicators, soft law etc. And, of course, finance too changes considering for example the risks of financial interconnectedness today, the growth of crowdfunding – and indeed the possible decline of the public company.

(iv) To conclude, Gerner-Beuerle’s article is important for anyone interested in the precise historical developments of UK and German company law, but also more generally as a piece that brings history into the field of ‘law and finance’ studies. This comment has outlined how these latter aspects can be related to other past, present and future considerations of a time-sensitive approach to ‘law and finance’. Of course, financial development is also not a means in itself. Thus, a future research agenda, could then also go further and explore the relationship between ‘law and non-financial development’ in company and securities law.
References


[2] In footnotes 6 and 222.


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