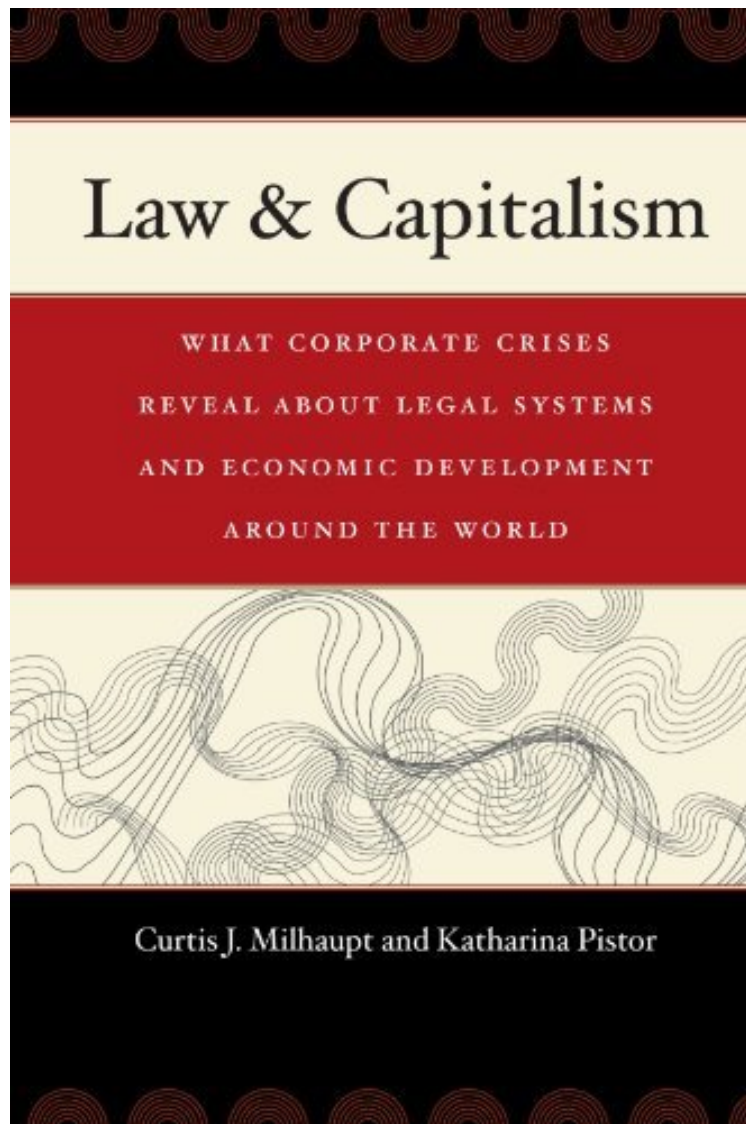


[PDF] Law Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World

Law Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World

Curtis J. Milhaupt, Katharina Pistor
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Curtis J. Milhaupt, Katharina Pistor : Law Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World before purchasing it in order to gauge whether or not it would be worth my time, and all praised Law Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World:

10 of 10 people found the following review helpful. How to Become the World's Most Often Cited Economist By

Etienne RPAndrei Shleifer, a Harvard University professor, became the most widely-cited economist in the world by exploiting an idea most people in the field think is wrong. The idea is that the origin of a country's legal system--the legal family to which it belongs--is a significant determinant of the effectiveness of its legal institutions. More specifically, countries belonging to the English common-law family are found to have a more business-friendly environment than countries belonging to the French and German civil-law families, with members of the Scandinavian civil-law family falling somewhere in between. The idea that "common law does it better" is not new. Friedrich Hayek had already proposed it, and quite a number of American legal scholars have endorsed it as well. According to their line of reasoning, the common law trumps the civil law because courts are better suited than legislatures to continuously adapt rules to the needs of market participants. (On the other hand, Max Weber believed that courts and jurisprudence-based law created complexities and uncertainties that were conflicting with the ideal of a predictable, efficient legal system that he believe was a foundation for economic activity.) What is different in Shleifer's and his coauthors' work is that they tried to put numbers on that idea. They first built an index of investor rights' protection, and then complemented it with other datasets reflecting many dimensions of doing business in a market economy: how to start a business, hire and fire workers, register property, enforce contracts, and so on. Running cross-country regressions, and after controlling for GDP per capita and other variables, they found that common-law countries did better on these measures than countries that had inherited their legal system from the French. Even when considering the quality of government, the effectiveness of courts, and the degree of corruption, countries belonging to the common-law family had better results than French civil-law countries. Those empirical results took academia by storm, and Shleifer and his coauthors were catapulted to the top of the rankings measuring the number of citations in social science journals. The "law and finance" literature, as it is called in academia, soon became a cottage industry. But as legal scholars Milhaupt and Pistor note, their results contradict the real-world experience of law reformers, and they are not even confirmed by the data. Law simply doesn't work that way. One of the reasons is because these studies make no attempt to differentiate between countries that developed their legal system internally from those that received their law by way of legal transplantation. Once this "transplant effect" is introduced in the regressions, the results found by Shleifer and alii disappears. In other words, the process of legal development--how countries build their laws and institutions--matters for the effectiveness of the legal system. Exogeneously imposed law rarely fits conditions in the host country without considerable adaptation by the local law-making community. Milhaupt and Pistor do prove the law and finance literature wrong by running cross-country regressions, but that's not the point. Focussing on indexes and statistical results makes the observer lose sight of the one-thousand pound panda bear in the china shop--namely, the People's Republic of China. China's GDP has grown at an annual rate of more than 9 percent for two decades, yet its legal system is highly underdeveloped, its corporate governance is problematic, and its capital market is small and inefficient. Chinese authorities use law reform in the economic sector as a signaling device: to ensure domestic actors and foreign players that the country is moving in the direction of market-based capitalism and legal governance. At the lawmakers' level, law is viewed primarily as a mean to control and coordinate the economy and society. China is pursuing rule by law as opposed to rule of law, especially if the later implies the use of law to control governmental action and protect the rights of the citizen. As Milhaupt and Pistor note, the law and finance literature has also been highly influential in policy circles, with the World Bank playing a pivotal role in spreading its philosophy to real-world situations and translating its postulates into legal reforms. The transformation of formerly socialist regimes into market economies, the Asian financial crisis and the indictment of crony capitalism, the globalization of capital flows, and other developments associated with corporate scandals or broader macroeconomic problems, all had the effect of transforming domestic legal systems along a fairly standard menu of legal reforms. The provision of legal assistance became a booming industry. More often than not, the policy response, applied liberally from Seoul to Warsaw, has been to re-create features of the US legal system that are thought to account in some way for the comparative robustness of US economic institutions. For Milhaupt and Pistor, a different approach is needed. The first step is to recognize the diversity of legal systems. Just as there are varieties of capitalism, there are varieties of legal support for capitalist activity. Different types of legal systems are conducive to economic success. Each has its own costs, benefits, and vulnerabilities. Among countries at roughly equivalent stages of advanced economic development such as the United States, Germany, and Japan, legal systems vary substantially in the process of lawmaking and law enforcement. The structure of the legal professions and their respective roles in the legal system vary significantly among the three countries as well. The second basic recognition is that law is not an endowment like a fixed capital investment that, once in place, provides a firm foundation for economic development. Law, like capitalism, is constantly evolving. The vibrancy of a capitalist system hinges on creative destruction in the sphere of legal governance as well as the economic sphere. Law constantly needs to be fine-tuned, revised and adapted to changing economic, social and political circumstances. The consequence is that one cannot simply take a new law from a book, or import it from abroad, and insert it in the proper place. The performance of a legal transplant depends on the extent to which the changes are aligned with the conduct of lawyers, judges, and bureaucrats in applying and enforcing the new law. The third pillar of the authors' approach is the acknowledgment that law performs a multiplicity of functions. The protection of property rights, which is the exclusive focus of the law and finance literature, is only

one possible function of law. In addition, the authors insist on the coordinating function of law, as when the allocation of rights to various stakeholders induce them to cooperate and bargain over outcomes in the best interest of the corporation. Laws can also be used to provide important signals to market actors and to lend credibility to government policies, enhancing their effectiveness. It can be argued that much of the legal development that has taken place in China since the early 1980s falls into this signaling and credibility enhancement category. The last building block is the role of the political economy in the supply and demand of legal systems. Making law is a political process through and through. Many actors, public and private, are involved in this process of creative destruction by which laws are created and revised, maintained and contested. A highly centralized legal system favors state-centered interest groups and actors. A decentralized legal system favors self-organized groups and individuals. In addition to the supply of formal law, the demand for law can vary over time and with changes in the constituencies who participate in market activity. The diversity and fluidity of legal systems, the functions they perform, and their relation to the political economy, as well as the demand for law, provide a useful framework for thinking about legal change around the world. Rather than reasoning in the abstract or testing hypotheses through statistical regressions, Milhaupt and Pistor chose to practice what they call institutional autopsies: they identify a case of corporate scandal involving complex legal issues, and they analyze the way each of the major stakeholders responded to the crisis and reshaped the law accordingly. Their sample include the Enron scandal and the passing of Sarbanes-Oxley by the US Congress; the Mannesmann executive compensation trial in Germany; the Livedoor bid and hostile takeovers in Japan; the renationalization of Yukos and the control over national resources by the Russian state, and others cases in Korea, China, and Singapore. In medicine, an autopsy is an important strategy for learning about the functioning of the human body. Likewise, focusing on a moment of stress is highly revealing of the underlying dynamics of a complex system, permitting unique insights into its vulnerabilities and propensity for change. Like the human body, economic and legal institutions are complex arrangements that defy simple mechanical analysis. Milhaupt and Pistor's institutional autopsies differ markedly from the approach favored by the law and finance literature. Focusing on numbers, the economist keeps his hands clean and invisible. By contrast, the lawyer, like the surgeon, gets his hands dirty by plunging them into the bowels and arteries of the capitalist system. Milhaupt and Pistor's hands-on approach may not propel them to the top of academic citation charts. But it may provide them with more success in the classroom and more lasting influence in the real world than the ratiocinations of economists bent on proving Hayek right, and Weber wrong. 12 of 14 people found the following review helpful. Publishing and Capitalism By not me NO ONE should be taken in by the grandiose title of this book. Anything called "Law and Capitalism" brings Marx and Weber to mind immediately. It can't help but raise expectations that it will probe and dissect two of our fundamental social institutions. Instead, this book is built around six short case studies of recent corporate crises (e.g., Enron) in six different countries. The cases are sandwiched between introductory and concluding chapters that wax social scientific and try to distill lessons for the field of law and development. The cases are interesting, but it isn't always clear how they contribute to the central argument; one gets the feeling they were selected because they were well-reported. In fact, the whole exercise feels like it was stolen from a class on comparative corporate law. It probably was. The authors' basic message is sensible, namely, that too many World Bank officials and development scholars, in their eagerness to find a legal "technology" to underpin economic growth, overlook messy realities about markets and the law. However, their own book is thin and ephemeral. Not recommended.

Recent high-profile corporate scandals—such as those involving Enron in the United States, Yukos in Russia, and Livedoor in Japan—demonstrate challenges to legal regulation of business practices in capitalist economies. Setting forth a new analytic framework for understanding these problems, *Law and Capitalism* examines such contemporary corporate governance crises in six countries, to shed light on the interaction of legal systems and economic change. This provocative book debunks the simplistic view of law's instrumental function for financial market development and economic growth. Using comparative case studies that address the United States, China, Germany, Japan, Korea, and Russia, Curtis J. Milhaupt and Katharina Pistor argue that a disparate blend of legal and nonlegal mechanisms have supported economic growth around the world. Their groundbreaking findings show that law and markets evolve together in a "rolling relationship" and legal systems, including those of the most successful economies, therefore differ significantly in their organizational characteristics. Innovative and insightful, *Law and Capitalism* will change the way lawyers, economists, policy makers, and business leaders think about legal regulation in an increasingly global market for capital and corporate governance.