

Legal origins and financial development: institutional aspect

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Introduction

The present report focuses upon the problem of interaction between legal origins and financial development. The analysis is approached from three vantage points: first, as an explanation of the main legal theories of financial development and differences between them; second as an empirical examination and analysis of the correlation between legal origins and indicators of financial development for the countries with the developed market economy; third as an establishment of the basic tendencies of the interaction between legal origins and financial development for the countries with the emerging market economies.

Scientists have no common opinion what classification of legal systems will be the optimal. They offer different criteria for division of the countries into legal families, beginning from historical features and finishing specificity of modern institutional development. However, all of them are unanimous that a starting point for research of country distinctions can be classification of legal traditions on civil and common law (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1998, p.1118).

In this connection, research of interrelation between legal origins and commercial laws lead by La Porta et al. is more relevant. Their investigation shows that commercial laws come from two opposite traditions: English law (common law) and Roman law (civil law) which is subdivided on French, German and Scandinavian traditions (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1998, pp.1118-1119). La Porta et al. examined 49 countries and established direct interrelations between legal origins and such indicators of financial development as laws governing investor protection, the quality of legal enforcement of these laws and substitute mechanisms for poor investor protection. However, their conclusions are supported only by empirical data without a theoretical substantiation.

Theory and methodology

Beck et al. considered this shortage and put forward legal theories of international differences in financial development. They analysed two channels, by means of which legal systems influence financial development.

First of all, Beck et al. separated the law and finance theory's political channel, leaning on which it is possible to establish interdependence between financial development and quality of protection of the property rights and the rights of outside investors in a historical retrospective show. Secondly, they separated the legal-adaptability channel, leaning on which it is possible to establish interdependence between financial development and adaptive abilities of legal system to minimize losses for the economy in case of changing commercial and financial conditions (Beck, Demirgüç-Kunt & Levine, 2001, p.484).

The present report is based on use of the theory of the adaptability channel, because it helps to examine not only differences in financial development between the countries of civil law and common law, but it also helps to reveal similarities between the countries of common and the countries of German civil law and distinctions between the countries of common law and the countries of French civil law (Mayer & Sussman, 2001, p. 463). Consequently, the adaptability of the legal system significantly influences financial development.

Furthermore, the theory of the adaptability channel indicates the relationship between legal origins and the institutional structure of the financial system. So countries with developed and market-based financial systems are by all appearances to have common law and German legal origins. In contrast, countries with underdeveloped and bank-based financial systems are much

more likely to have French legal origins. Hence, the structure of financial systems is a product of the legal system within which they operate (Demirgüç-Kunt & Levine, 2001, pp.123-126).

Therefore, on the basis of the presented theoretical substantiation it becomes easier to explain the empirical interrelations between legal origins and such indicators of financial development as laws governing investor protection, the quality of legal enforcement of these laws and substitute mechanisms for poor investor protection which are resulted in La Porta's researches.

Special references to the Russian case

At first sight, investigation of the presented problem seems completed. However, the researches lead by La Porta et al. cover only the countries with the developed market economy, without taking into account the countries with the emerging market economies ('transition' economies) which have not got in their classification, in particular Russia (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1998, p.1117).

Russia is jurisdiction of civil law. The civil Code of Russia represents consolidation of the basic legal principles supporting economic relations. It is complemented by legislative acts about regulation of the business activity, for example, the law of joint stock companies (Pistor & Xu, 2002, p.22). However, in spite of serious legislative base, Russia is characterized as a country with weak investor protection, great ownership concentration, smaller stock market and low valuation of firms (Stepanov, 2005, p.1). As a result, it negatively influences on financial development and reduces economy's growth rate.

The explanation of the given paradox is concluded that Russia as a country of civil law traditions has similarities with French civil law. Besides, effective realization of principles of market economy is laboured the circumstances of transitional period. Therefore, Russian authorities try to perfect the legal system in the direction of investor protection, legal enforcement and corporate governance. As a consequence, the market valuation of the Russian firms rises, that does them more attractive for external financing, and also allows to sell a part of their shares in order to diversify their holdings. Hence, these results are the pre-conditions for the future financial development.

At the end of the present report it is necessary to outline two main consequences. First of all, the countries of common and the countries of German civil law provide the strongest legal protection than the countries of French civil law. Therefore these countries are more financial developed and they can enter a new market or industry more easily and have higher economy's growth rate. Secondly, legal origins help to the countries with the emerging market economies to develop their own mechanisms of financial development and subsequent economic growth.

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