

Legal Origin, Growth and Financial Market Development: An Empirical Analysis

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Relation between a country's legal system, laws and policies is interesting. Civil law countries tend to have more regulations in the market than the common law countries. Economists have drawn a link between the legal system of a country and the growth of the financial market. Specific characteristics of the legal system impact the market operations. The common law system tends to regulate lesser than its civil law counterpart. The assumption was that the pro-market characteristics of the latter promoted investor rights leading to higher growth of the former. However, this has not proved true. Several common law countries have failed to trigger financial market development owing to stringent financial policies. On the contrary, most civil law countries have grown substantially. We analyze the empirical relationship between legal origin of a country with the financial market development and economic growth. We examine whether there is any statistically significant relationship between Judicial Quality, HDI and GDP. Legal origin and perception about the judicial quality do not affect the growth performance among selected civil and common law countries. It is rather the endogenous institutions such as Judicial Quality, Contract Enforcement, Labour and Financial Market regulations which aligns with the economic policies and influence the economic growth of a country. Using a robust VECM model, our results are consistent with the prediction of institutional economics which argues in favour of special attention to the local institutions rather than global performance indicators. The divergent growth performance of sample countries is largely attributed to the economic policies adopted and not the institutional reforms prescribed by the global think tanks.

I Introduction

“Institutions are the humanly devised constraints that structure political, economic, and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights). Throughout history, institutions have

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