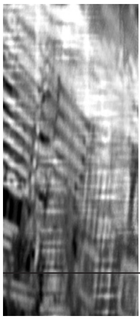


Lowering the Cost of Capital in Emerging Market Economies

ERIK BERGLOF, PATRICK BOLTON, SERGEI GURIEV, AND EKATERINA ZHURAVSKAYA

Corporate governance and bankruptcy in emerging market economies should be understood in a broader framework of corporate finance in institutionally weaker environments. In this conceptual paper we provide the outlines of such a framework and identify key trade-offs that can help structure the policy debate. As debt financing from banks is the major source of finance for companies in these economies and bankruptcy is the crucial mechanism for protecting investor rights, corporate governance and bankruptcy reforms are intimately linked. The priorities for these reforms depend critically on the specific institutional context. Consequently, they may differ across countries. In particular, the policy recommendations for emerging market economies are substantially different from those in OECD countries; there is no "one-size-fits-all" solution. Recognizing the need for diverse policy solutions that fit the cultural, political, and economic environment of each particular country, our paper focuses on the core economic principles and mechanisms of corporate governance and bankruptcy in emerging market economies and how they can help us understand the costs and benefits of various policy options.

Introduction

Corporate governance and bankruptcy are central to the policy discussion in emerging market economies (EMEs). In principle, all major corporate governance and bankruptcy issues and solutions in developed economies are pertinent for EMEs. However, many core debates in the United States and other developed countries mainly deal with public corporations with dispersed ownership, and thus are of less immediate concern to

Erik Berglof is chief economist of the European Bank of Reconstruction and Development, London. Patrick Bolton is Barbara and David Zalaznick Professor of Business, Columbia Business School. Sergei Guriev is Human Capital Foundation Associate Professor of Corporate Finance and Rector of the New Economic School, Moscow. Ekaterina Zhuravskaya is Hans Rausing Associate Professor of Economics and Academic Director of the Centre for Economic and Financial Research at the New Economic School. This paper is based on the Report on Corporate Governance and Bankruptcy for the Initiative for Policy Dialogue at Columbia University. The authors thank Irina Levina for research assistance.

Annual World Bank Conference on Development Economics 2007

EMEs. For example, issues relating to independent directors and the functioning of boards, executive compensation, hostile takeovers, or shareholder activism, which pervade the financial pages of the *Wall Street Journal* and the *Financial Times*, are not burning issues for most EMEs. Similarly, debates relating to whether debtors should be allowed to remain in possession of the firm after having declared bankruptcy, or whether there should be stricter limits on courts' authority to grant new priority financing, as interesting and pertinent as they are for mature market economies, may not be the priorities of bankruptcy reform for EMEs. Unfortunately but understandably, most of the existing academic literature on corporate governance and bankruptcy deals with such issues.

In contrast, the key corporate governance and bankruptcy issues in EMEs have to do with bank-financed, privately held small- and medium-size firms and with the role of the state in managing the largest corporations. The main corporate governance and bankruptcy concern in EMEs has to do more with credit rationing caused by poor enforceability of debt contracts and asymmetric information than with self-dealing by managers of publicly traded corporations. Banks and the state play a more dominant economic role in EMEs and the issues that are of concern for large, widely held corporations in developed economies mainly show up at the level of bank governance and state intervention. EMEs also face a relatively higher shortage of capital, and governance issues are mainly concerned with the problem of lowering the cost of capital and fostering business investment.

In this paper, we sketch a framework for the analysis of corporate governance and bankruptcy in EMEs and identify trade-offs that can help inform the policy debate. Despite important cross-country differences, lack of enforcement and market failures compounded by government failures are overriding concerns for corporate governance and bankruptcy, implying that these institutions should be analyzed within the same framework.

Corporate Governance, Bankruptcy, and Economic Development

Many if not most emerging market economies are currently enjoying extraordinarily easy access to financial capital. In our view, this situation is in large part a reflection of the extended period of high growth in developed markets. A global downturn is likely to change investors' willingness to absorb emerging market risk. Previous experiences, most recently the Asian and Russian crises in the late 1990s, suggest that it is in these situations that a country's institutions are truly tested.

We shall take as our starting point the common observation that a typical emerging market country has an abundant supply of cheap labor but lacks physical and human capital. The main economic reason why per capita income is low in most developing countries (by the standard of somewhat simplistic neoclassical economic reasoning) is that hourly productivity of the average worker is low. And, hourly productivity is low because physical and human capital are both low. In addition, the technology of production and basic infrastructure in place in most EMEs normally lag significantly behind the more advanced industrial economies.

This reasoning has led many economists to the conclusion that the transition out of underdevelopment can be accelerated by easing the flow of capital from capital-rich countries, where the marginal return on capital is relatively low, to the capital-deprived EMEs. However, it is remarkable that, even as global financial markets have become increasingly integrated, the capital per worker differentials between high-income and low-income countries remain large. Indeed, as Gourinchas and Jeanne (2006) and others have documented, countries that are not members of the Organisation for Economic Co-operation and Development (OECD) have so far benefited very little from financial integration, with the striking exception of China and other South-East Asian Tigers before the 1997 crisis. Why are capital flows between high-income and low-income countries are so low? Why aren't capitalists grabbing what appear to be free arbitrage gains by moving their investments from high-income to low-income countries?[1]

There are many important obstacles to the flow of capital to EMEs—such as the lack of transport infrastructure, cultural and linguistic barriers, and low education and human capital in the host country—but what appears to be generally true is that differences in capital concentration across countries are larger than regional differences within countries. Thus country-specific institutional obstacles—the way countries are run; their political and legal systems—are likely to be among the most significant factors hindering the flow of capital to its highest value use.[2] Gourinchas and Jeanne (2006) estimate a so-called country's *capital wedge* (an implicit or explicit country "tax" on capital income). They find that the capital wedge is higher in low-income countries and lower in middle-income countries, including, in particular, the fast-growing economies of China, India, and South-East Asia. What drives the cross-country difference in the capital wedge?

Of course, capital may not flow to developing countries because economic returns are low—for example, human capital is weak or infrastructure is poor—or because macroeconomic risks are high. However, capital flows may also be low because *private returns* to new investment in physical and human capital in emerging market economies are low. Three kinds of factors influence these returns. First, investors must be better protected from expropriation (they must have incentives to provide capital). Second, firms must be efficiently governed (capital provided by investors must be allocated correctly). Third, human capital matched with physical assets must be efficiently used (hence individuals must have incentives to accumulate human capital and not take it out of the country).

These three factors constitute the problem of corporate governance, broadly defined both as protection of investors (Shleifer and Vishny 1997) and as protection of quasi-rents generated by firm-specific investments (Zingales 1998). Indeed, capital income suffers both from the outright expropriation in favor of insiders and other stakeholders and from the waste due to inefficient governance, suboptimal incentives, and internal misallocations. Moreover, the two sides of corporate governance are often interrelated: expropriation of outside investors may be costly for internal efficiency, as discussed in Jensen (2005) and Friebel and Guriev (2005).

Effective corporate governance can also improve allocation of risks and reduce transactions costs of bargaining over rents (Zingales 1998). Both are very important in emerging market economies, where insurance markets are not developed, legal adjudication is costly, macroeconomic imbalances are large, and political risks are high.

As a result, the risk premium in EMEs is higher for investments in both physical capital and human skills. Macroeconomic instability and weak institutions are interdependent. Improvements in the protection of outside investors, governance inside firms, and incentives to accumulate human capital are likely to contribute to more stable economic and political conditions. At the same time, a more stable macroeconomic environment is in itself an important determinant of investment decisions.

The Role of the State in Emerging Markets

The role of the state in EMEs is complex. The often-lower quality of EME governments and more widespread corruption can result in a higher cost of government intervention. Far too often *government failures* reinforce rather than makes up for market failures (see Stulz 2005, who argues that the "twin agency" problem of investor expropriation by both insiders and government may fatally undermine investment). When faced with basic government shortcomings, it is tempting to conclude that the path to reform inevitably requires the disengagement of the state from economic management and control. Indeed, a central tenet of development advice of the World Bank, the International Monetary Fund (IMF), and other development agencies has been to encourage privatization around the world as a way of scaling back the role of ineffective and corrupt governments.

As shown in Megginson (2005), in the majority of instances (for which data are available) privatizations have also been liberating and led to faster development and growth both at the firm level and at the level of economy. But there have also been situations where privatization has achieved little and may have been counterproductive (see, for example, Brown, Earle, and Telegdy 2006). One important concern with unbridled privatizations, for example, is that they may replace an admittedly dysfunctional institution (a corrupt and inefficient state owner) with an institutional vacuum. Moreover, the process of privatization itself may be corrupt and may simply magnify an underlying government corruption problem and result in illegitimacy of property rights.

In addition, as there are many more market failures in EMEs, there is a greater scope for the government intervention. In the face of these potential problems, privatization is not necessarily the best way to resolve the initial governance problem of a dysfunctional and corrupt state, at least in the absence of complementary institutional reforms. If politically feasible, a more complex and more painstaking gradual improvement of the workings of government may ultimately be a more successful and sustainable approach to development. If the allocation of investment funds and government procurement is corrupt and inefficient, then perhaps the direct reform of procurement processes and closer oversight of the management of state assets may be a more fruitful reform than the radical and ultimately illusory disengagement of the state from economic affairs through mass privatization. Without a critical mass of private owners, however, it is not clear whether a deep reform of the government can either be called for or effectively monitored by the society (Boycko, Shleifer, and Vishny 1995).

Finally, there is a potential role for the state as a facilitator and catalyst of institutional change, but when it cannot disengage from the ownership and management of individual firms it easily gets bogged down by the sheer resources required. Moreover, conflicts of interests arising from the involvement in individual firms may undermine the development impact of any effort to resolve coordination problems.

Our Approach

Not only are there different reasons for the low private returns to capital in many emerging market economies, but different solutions may also be needed. Even in mature market economies, there is no first best solution to the problems of corporate governance and bankruptcy. In reality, there is considerable variation in legal rules and institutions across countries and over time. Optimal corporate governance and bankruptcy institutions are necessarily second best solutions to multiple collective action and moral hazard problems. Since the nature and extent of the collective action and moral hazard problems are likely to vary considerably across firms and countries, the same corporate governance institutions cannot be appropriate for all firms and countries. There is no "one-size-fits-all" solution.

Recognizing the need for diverse policy solutions that fit the cultural, political, and economic environment of each particular country, our paper focuses more on the common economic principles and mechanisms of corporate governance and bankruptcy across EMEs and attempts to identify the costs and benefits of various policy options. It is useful to acknowledge that not only do different environments call for different policy responses (see Skeel 2004), but also that the enforcement of the same law or policy may be very different in different countries (Berkowitz, Pistor, and Richard 2003).

Key Trade-Offs in Corporate Governance in EMEs

Corporate governance is the end result of a complex interaction between a number of mechanisms constraining management of a firm, allowing it to commit to certain corporate strategies and future payouts of profits. Large blockholdings of equity is probably the most direct such mechanism. Holders of such blocks need to find ways to commit themselves toward management and investors with minority stakes: for example, by listing on exchanges offering a strong regulatory framework and potentially opening themselves to takeovers. Governance by commercial banks may also facilitate commitment for managers and controlling owners. However, concentration of ownership reduces liquidity of equity markets and reduces the power of market for corporate control and the board of directors as corporate governance mechanisms.

In reforming corporate governance policymakers face a number of important tradeoffs and dilemmas.

Developing a Broad Stock Market or Encouraging Delisting?

Stock market development involves protection of minority shareholders, which may reduce mobility in the market for corporate control and slow down ownership consolidation. On the contrary, policies promoting delisting—such as squeeze outs, freeze outs, and breakthrough rules—encourage more efficient takeovers but undermine broad share ownership (Berglof and Burkart 2003). Insofar as the benefits of concentrated ownership outweigh its costs, mobility in the control market is preferable. This trade-off is especially salient in Central and Eastern Europe, where after very different reform paths, ownership has become increasingly concentrated and stock markets remain shallow (Berglof and Bolton 2002; Berglof and Pajuste 2003). However, investors' willingness to take large control blocks is undermined when controlling owners are made too easy to replace: for example, through rules restricting their ability to exercise their control when faced with a takeover threat, such as in the so-called "break-through" rule discussed in the context of the European Union takeover directive.

Where possible, the trade-off between stock market development and effective governance by controlling shareholders is best resolved at the firm level rather than at the country level. The policies should aim at lowering the costs of self-selection into listed and nonlisted companies. The limited enforcement capacity should then be focused on the public companies, strengthening the commitment value of going public.

Transparency versus Business Secrecy

Enforcing disclosure is one of the major tools for reducing costs of outside financing (LaPorta, Lopoez-de-Silanes, and Shleifer 2006). Yet disclosure may constrain managerial initiative and increase the risks of expropriation by the government. This is why the optimal disclosure depends on firm-level characteristics such as investment opportunities, ownership structure (Ostberg 2005), and the political risk, which can also be firm-specific (Goriaev and Sonin 2005). Hence mandatory disclosure rules may be socially suboptimal.

In addition, too much transparency can be costly for businesses whose comparative advantages are more efficient business processes or production technologies. For example, firms in the United States approach special financial intermediaries such as venture capitalists, whose reputational concerns prevent them from abusing access to information. Yet the venture capital market does rely substantially on a developed legal system (Kaplan, Martel, and Stromberg 2004) and may not function well in most emerging market economies.

In designing and enforcing transparency requirements, focus should again be given to those aspects of information that truly enhance the commitment ability of firms. Disclosure of the governance arrangements themselves, in particular a firm's ownership and control structure, should be a basic element in any transparency policy. At the same time, it is important not to overburden small firms with demands of information. Encouraging the development of information intermediaries is a viable alternative.

Courts versus Regulators

Glaeser, Johnson, and Shleifer (2001) argue that aggressive regulation of securities markets may outperform reliance on courts in transition economies. They explicitly model the incentives of judges and regulators and show that in some cases the politically motivated regulators may be better suited for environments with weak institutions. In particular, they argue that strong regulation helped the Polish stock market overtake the Czech one in the 1990s. Yet their analysis implies that the optimal solution would be very different for different emerging market economies. Later evidence suggests, however, that regulatory enforcement, at least of transparency requirements, is lower and deteriorating in Poland, where as the Czech Republic has gone through a remarkable improvement in recent years (Berglof and Pajuste 2003).

China represents a very special case where all listed companies are government-owned and both judges and regulators are government-controlled. Thus one would expect both courts and regulators to exhibit a pro-government bias. Yet China has managed to provide political incentives through yardstick competition. As the central government has set regional listing quotas, the securities regulator, the China Securities Regulatory Commission, has engaged the support of provincial governments to select and regulate listed companies (Du and Xu 2005). Such a federalism-based incentive structure is not costless, however. Boyreau-Debray and Wei (2005) show that capital mobility across Chinese provinces is actually surprisingly low.

We are not convinced that there is a simple choice between courts and regulatory intervention. Most of the time, the two mechanisms complement each other. It is not obvious that one of the mechanisms is more sensitive than the other to broader institutional environment. The Chinese example suggests that they are both susceptible to external influence, particularly by the government. Again, China offers an example of how the government can improve its ability to commit not to intervene by delegating decisions.

Corporate Law and Regulation versus Corporate Chapters and Codes

As argued above, corporate governance in EMEs may be voluntarily improved by individual firms (Durnev and Kim 2005). Yet even as uniform regulation is too blunt and indiscriminate, decentralized charters impose a substantial burden on courts (Burkart and Panunzi 2006). The intermediate solutions are codes that are more flexible, allowing companies to sort according to their preferences and needs for stricter or softer corporate governance rules.

Shareholders vs. Stakeholders

The policies above discuss the trade-offs with regard to maximizing shareholder value. However, the firm's objective function may also include payoffs to stakeholders including labor, national and regional government, suppliers, and customers (we discuss creditors separately in the bankruptcy section). In EMEs, a stakeholder perspective may be particularly important when considering policy responses. First, in virtually all EMEs, stakeholders play an important role in running firms. Second, stakeholders' intervention may be socially optimal. Indeed, if redistribution through government is rather costly (for example, if taxes, the pension system, and public education do not function properly), corporations may be a more efficient channel for solving social issues. Also, if labor and product markets are segmented, corporate decisions impose substantial externalities on employees, suppliers, and customers, and therefore pure profit maximization may be socially suboptimal.

On the other hand, an excessive focus on stakeholders carries important risks (Tirole 2001). Intervention by the government or other stakeholders weakens the incentives of the controlling owner/manager and hence lowers internal efficiency. These costs are especially high in EMEs, where stakeholders are not well-organized and governments are often inefficient and corrupt. For example, if trade unions are not functioning well, labor's interests are protected by other stakeholders, such as national or regional governments, which exacerbates the costs, as stakeholders themselves suffer from the multi-tasking problem.

Lessons from Corporate Governance Trade-Offs

These trade-offs emphasize the difficulty of "one-size-fits-all" solutions. Still, the above analysis offers some simple insights that would ease most of the trade-offs in every economy. It is a first-order objective to pursue the protection of property rights of entrepreneurs. Once their rights are protected, they will have weaker incentives to capture the political and legal processes and stronger incentives to develop good corporate governance. Another important insight concerns the role of commercial banks, and more generally creditors, in corporate governance in EMEs. Since stock markets are underdeveloped, most companies in these countries rely on bank credit and bonds. As a result, the protection of creditors is an important institution needed for external finance and corporate growth. We discuss the challenges of promoting credit markets in EMEs in the next section.

Integration into the global financial system (such as access to global financial markets and the insurance industry) can help mitigate most of the problems above and reduce the costs of second best solutions. For example, foreign listings have been an important means for individual firms to break out of weak institutional environments. International media can also be helpful. For firms to build reputation, reputational intermediaries are critical. Foreign business press appears to play a positive role in this respect, at least in some countries.

Key Trade-Offs in Designing Bankruptcy Laws in Emerging Market Economies

Our proposed framework has implications for how to think about bankruptcy reform, or more broadly reform of debtor-creditor law, in emerging market economies. Generally speaking, bankruptcy law deals with conflicts between a debtor and its creditors, and with conflicts among creditors. On one hand, bankruptcy law should provide a mechanism to *discharge* or wipe out all the debts of a failing business and thereby to provide insurance to entrepreneurs against large losses that may be produced by factors beyond their control. On the other hand, for a creditor to lend money to the entrepreneur in the first place, debtor-creditor law must protect her rights.

When firms have multiple creditors, bankruptcy law makes sure that failing firms are liquidated efficiently, that debtors have an incentive to repay creditors when they are solvent, that bankrupt firms are restructured in an orderly manner, that assets of bankrupt firms are not disposed of in a fraudulent way, that seniority of claims among creditors is enforced, and that asset substitution and diversion of assets by management or a subset of creditors is prevented.

Based on how creditor rights are allocated, we can identify at least four key dimensions distinguishing existing bankruptcy systems from one another: the degree of friendliness toward debtors (or creditors); the orientation toward liquidation or reorganization of firms; the bias *among* creditors (such as secured versus unsecured creditors, or banks versus bondholders); and the extent of court involvement. Bankruptcy systems around the world vary a great deal in how they allocate creditor rights. Even developed market economies differ considerably in bankruptcy design. In the United Kingdom, the law is viewed as creditor-friendly, with a strong bias toward liquidation and conflict resolution delegated to a key creditor. In contrast, the U.S. system is considered debtor-friendly, with strong incentives against banks getting deeply involved in restructuring firms, and with the courts given a major role in bankruptcy. As for corporate governance, it is hard to claim that there is a "one-size-fits-all" system.

As for other property rights, a number of factors influence how a particular legal text eventually is implemented. Bankruptcy procedures, particularly in less developed economies, are susceptible to capture by specific interests, sometimes combining tools provided them by bankruptcy law, wealth of resources, and political clout as large investors or employers. Actors in the economy learn how to use the system; those who use it more often and those with more resources are likely to learn the most. If large private creditor institutions exist, they are more likely to be in repeated proceedings, implying that there would be an inherent tendency toward more creditor-orientation in the implementation of laws. For example, some observers of the U.S. bankruptcy system argue that it is much less debtor-friendly in practice because of the extensive learning of large creditors, whereas in the United Kingdom, informal practices have developed—the so-called London Process—to introduce more debtor-friendly features.

In the discussion that follows, we discuss the most important policy trade-offs that a designer of bankruptcy policy faces in any emerging market economy. We also describe existing evidence on the resolutions of these trade-offs, when such evidence exists.

Ex Post versus Ex Ante Efficiency

The most fundamental trade-off in debtor-creditor law is that between ensuring creditors sufficient protection to extend credit and allowing the entrepreneur a fresh start in case of default when the cause is beyond the his control. The latter function is a key driver of entrepreneurship. Most entrepreneurs would probably not take the risk of founding a new business if they faced unlimited liability. All advanced market economies (with few exceptions) have entirely eliminated debtors' prisons and other criminal penalties for default (unless the debtor was found to have fraudulently expropriated creditors). The main driving force behind the trend toward decriminalizing default has been that the benefits of fostering entrepreneurship outweigh the cost of reduced incentives to repay one's debts. The possibility of relief is particularly important in emerging market economies, where volatility is high and social insurance systems are poor.

However, an important lesson from the recent literature is that poor borrowers are hurt by excessively lenient enforcement of debt contracts. Although weak enforcement obviously helps a financially strapped borrower ex post, it also raises the cost of borrowing ex ante and results in the exclusion of poor borrowers from credit markets. On the rare occasions when bankruptcy reform is discussed in public debates, one observes a general misperception in the public at large that if the preservation of employment at all costs is not viable, then at least the pursuit of ex post efficiency is desirable. These policy debates miss the fundamental point that there is a trade-off between ex ante and ex post efficiency: greater creditor protection ex post often works to the advantage of debtors ex ante. Thus a very strong case could be made for creditor control of bankruptcy procedures on ex ante efficiency grounds. The contrast in India is particularly revealing between the rapid growth in automobile loans and mortgages following the passage of the SARFAESI act in 2001, which culminated the legal reforms started in 1993 with the establishment of debt recovery tribunals (see Visaria 2006), and the previous anemic markets for those loans.

A noteworthy feature of the EME environment is the coexistence of a modern, primarily urban manufacturing sector and a much less developed, often rural agricultural sector based on small and medium-size enterprises. Naturally, firms in these two sectors are financed in very different ways. This has implications for what kind of bankruptcy law best corresponds to the needs of firms and investors. This dual nature of the economies raises the issue of the pro's and con's of having separate chapters corresponding to the different needs of the two sectors. Since entrepreneurship and small business growth are particularly important in developing countries, the benefits of "fresh start" policies that allow debtor-entrepreneurs to obtain relief from debt despite less-than-full creditor repayment (leaving some funds to the entrepreneur) arguably are greater than in developed economies. Thus it might be beneficial to have special "soft" bankruptcies for small firms and individual entrepreneurs. (It is worth noting that for the large firms, the benefits of fresh start are negligible.) There are, however, important arguments against such a solution (Ayotte 2007). First, if small firms are treated preferentially ex post, incentives to expand business and grow may be undermined (as often is the case in Brazil and India). Second, if the bankruptcy code is too soft on small firms ex post, it should be difficult for them to get finance ex ante, which may hurt their possibilities of growing.[3]

The "ex ante versus ex post efficiency" trade-off is behind most of the specific policy choices in the design of bankruptcy law. We discuss the most important aspects of this trade-off in the next few subsections.

Reorganization versus Liquidation

A related consideration in designing bankruptcy law is how to strike the right balance between reorganization and liquidation. On the one hand in emerging market economies, labor markets tend to function less well and social safety nets are less developed, suggesting that the social costs of liquidation of firms are higher. Broader structural changes in industry are also likely to take place across different industries rather than within industries, implying larger costs of adjusting (Shleifer and Vishny 1992). On the other hand, those EMEs that are growing rapidly can more easily absorb human capital made redundant. But even less fortunate developing countries often have no means apart from liquidation to transfer assets from the inefficient to more efficient uses. Because both their capital markets and their markets for corporate control are dysfunctional and their economies highly politicized, they must release workers to other parts of the economy. This is particularly important in transition economies with strong insider control. In these economies, liquidations should be particularly harshly enforced for the old (formerly) state-owned firms; yet these firms are usually the ones that get bailed out.

On balance, bankruptcy law in emerging market economies should probably have a liquidation bias—except for the largest firms—because reorganization procedures are much more complex than liquidation procedures. To be effective, reorganizations necessarily require a more effective judiciary and more competent bankruptcy practitioners. Overall losses associated with reorganization procedures on average are likely to be larger than those of liquidation procedures. Cross-country evidence supports this claim. The *Doing Business 2005* report (World Bank-IFC 2005) shows that the most efficient bankruptcy laws in developing and transition countries prescribe simple, fast, and cheap liquidation procedures.

One cannot argue a priori, however, that liquidation procedures are less susceptible to capture than reorganizations. Thus the distributional consequences of the choice between reorganization and liquidation bias depend on the distribution of political power and wealth among the conflicting parties. For example, asset diversion may make liquidations extremely debtor-friendly. Thus a close monitoring of all transactions in bankruptcies by the interested parties in the conflict should be allowed.

Dealing with Systemic Crises versus Ex Ante Incentives

Much of the evidence and economic analysis on the bankruptcy process in EMEs in normal times clearly points in the direction of the benefits of simplified debt resolution procedures controlled by creditors. Unfortunately, in the event of a macroeconomic crisis, the macroeconomic environment and especially the greater exposure of EMEs to systemic shocks also clearly points in the direction of introducing exceptions in the implementation of these simple rules.

In light of the fact that shocks in institutionally less developed economies tend to be strongly correlated across firms, several proposals have been floated to allow for economy-wide stays on the liquidation of assets of distressed firms in the event of a major crisis, such as the Asian crisis of 1997 and the Russian crisis of 1998. If firm performance and asset values are temporarily reduced because of a macro shock, it makes little sense to plunge the economy into an even worse economic state by closing down otherwise healthy firms on a massive scale. Instead, much of the temporarily distressed value of these firms can be rescued through a coordinated macroeconomic response that lets these firms ride through the worst of the storm and increases the aggregate demand for their products.

While such "Super Chapter 11" arrangements (see Miller and Stiglitz 1999) are clearly attractive alternatives ex post when many firms simultaneously are facing bankruptcy, it is less well understood that the ex ante effects of such an option are likely to be adverse, particularly in weak institutional environments. Such procedures—allowing for partial debt cancellations, moratoria, or bailouts during major economic downturns—are very vulnerable to capture by special interests, thus exacerbating credit rationing. However, when the integrity of the political process is sufficiently strong, efficiency can be improved not only ex post but also ex ante, as has been shown by Bolton and Rosenthal (2001, 2002).

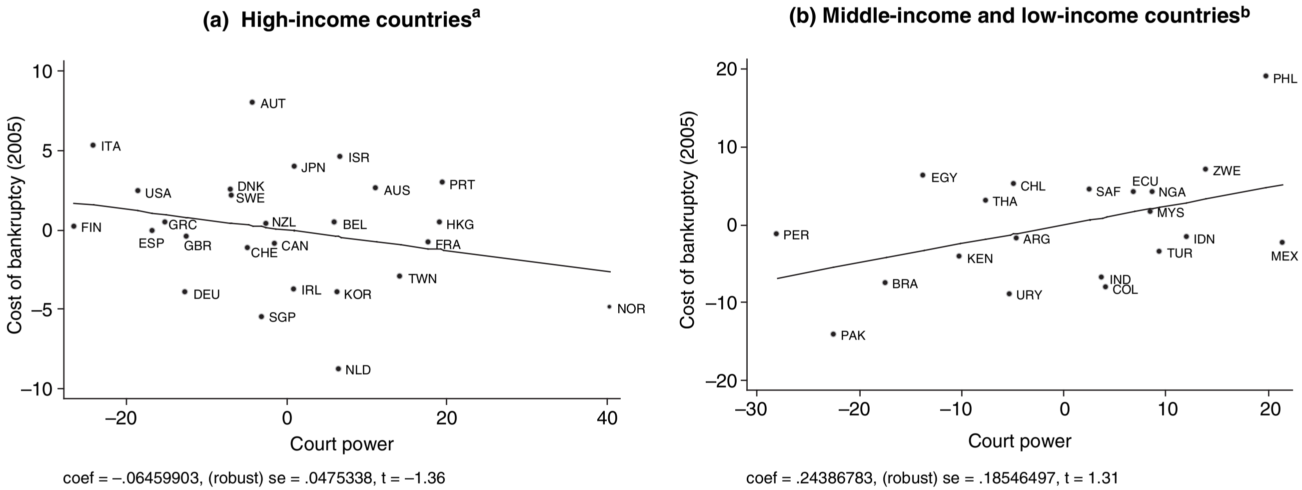
Another important caveat to the implementation of simple creditor-controlled bankruptcy procedures with a liquidation bias in EMEs has been vividly demonstrated by the recent bankruptcy reform experience of Hungary. If, like Hungary in 1990, a country undertakes a drastic bankruptcy reform and immediately tightens previously *soft budget constraints*, the numbers of insolvent firms should be expected to increase because of the backlog of bad loans and tax arrears. This wave of new insolvencies can overwhelm bankruptcy courts in the short run, as it did in Hungary, and give rise to a serious political backlash. The hasty implementation of the "automatic bankruptcy trigger" was the reason for the country's credit crunch in the early 1990s and contributed to discrediting the reforms (Mitchell 1998; Bonin and Schaffer 2002).

Judicial Discretion versus "Automatic" Liquidations

An important dimension in designing bankruptcy laws is how much discretionary power to give to courts. One rationale for giving discretionary power to the judge is to prevent socially inefficient liquidations that could result if some parties who have a stake in the firm, such as employees, local communities, and tax authorities, do not have a voice in the decisions affecting the future of the firm after default. Thus, for example, the stated goal of French and Indian bankruptcy laws is to preserve employment. This is an important reason why these laws have been designed to concentrate most powers in the hands of the bankruptcy judge and to leave much less room for negotiations between the debtor and the creditors than under, say, U.K. or U.S. bankruptcy law. As is widely recognized, however, bankruptcy judges generally do not have the expertise to turn around businesses in financial distress and are not well equipped (or motivated) to make important and complex business decisions to reshape a viable future for the failed firms in a timely fashion. More often than not, the reality of court-supervised management of bankrupt firms in France and India is a gradual and systematic destruction of the remaining value in the bankrupt firm.

The effect of discretionary power of courts on financial costs of bankruptcy differs significantly between high-income and low-income countries. Higher discretionary power of courts appears to be positively correlated with the financial costs of bankruptcy across poor and middle-income countries and (slightly) negatively across rich counties (see *Doing Business 2005* and figure 1).

FIGURE 1. Judicial Discretion and the Overall Administrative Cost of Bankruptcy



Source: Authors' calculations based on data from *Doing Business 2005,* http://www.doingbusiness.org.

Note: Difference in the slope of the regression lines in the two samples is robust and always statistically significant. Graphs show residual correlation after controlling for per capita income, legal creditor rights, legal origin, level of the rule of law and the level judicial efficiency.

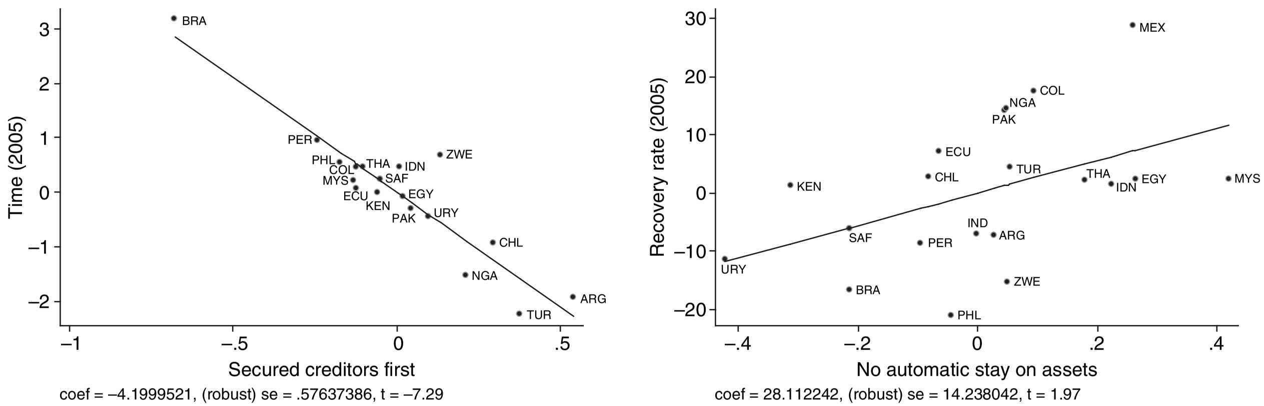
a. The effect in high-income countries is sensitive to the presence of Norway and the Netherlands.

b. The effect in low-income countries is robust in the direction and magnitude and for a wide number of specifications.

FIGURE 2. Legal Creditor Rights and Efficiency of Bankruptcy Procedures in Poor and Middle-Income Countries

(a) The provision for secured creditors to be paid first in liquidation procedures[a]

(b) The provision of no automatic stay on assets



Sources: Djankov, McLiesh, and Shleifer (2004) and authors' calculations based on data from *Doing Business 2005,* http://www.doingbusiness.org.

Note: The figure shows that the *only* two legal creditor rights that matter for efficiency of bankruptcy procedures across countries in the subsample of low-income and middle-income countries are the provision for secured creditors to be paid first in liquidation procedures (panel a) and the provision of no automatic stay on assets (panel b). The panels show residual correlation after controlling for per capita income, legal creditor rights, legal origin, level of the rule of law and the level judicial efficiency.

a. In the figure for time versus secured creditor's position in priority rule, there are two outliers: Mexico, with secured creditors after employees and government and quick bankruptcy resolution; and India, with secured creditors first in the queue and long bankruptcy. Even though they are omitted, the relationship is statistically significant even when they are included. The relationship also does not depend on the inclusion of Brazil.

TABLE 1. Time Needed to Go through Insolvency and the Cost of the Procedure, 2004

a. Fifteen countries with the slowest bankruptcy	Time (years)	b. Fifteen countries with the most costly bankruptcy	Cost (% of estate)
Marshall Islands	5.3	Fiji	38
Vietnam	5.5	Panama	38
Chile	5.6	Sierra Leone	38
Philippines	5.6	Congo, Rep.	38
Haiti	5.7	Macedonia, FYR	38
Belarus	5.8	Venezuela	38
Indonesia	6.0	United Arab Emirates	38
Palau	6.5	Marshall Islands	38
Maldives	6.7	Philippines	38
Oman	7.0	Palau	38
Mauritania	8.0	Micronesia, Fed. Sts	38
Czech Republic	9.2	Haiti	38
Brazil	10.0	Central African Republic	76
India	10.0	Lao PDR	76
Chad	10.0	Chad	76

Source: Doing Business 2005, http://www.doingbusiness.org

Note: Twenty-one countries have cost of bankruptcy equal to 38 percent of the estate. Among these countries, the table reports the ones that also have the lowest recovery rates. The actual differences in recovery rates as a result of reorganization procedures between high-income and low-income countries are large: on average, recovery rates are 67 cents on the dollar in high-income countries; 34 cents in middle-income countries; and 21 cents in low-income countries (*Doing Business 2005*).

Specialized versus General Courts

Bankruptcy reform has often focused on the need for a separate, specialized bankruptcy court system, or whether bankruptcies are best handled in regular courts. Prima facie, it is difficult to say whether specialized courts are more or less vulnerable to capture and corruption (which should be the overriding considerations in thinking of designing bankruptcy court system). Cross-country evidence, however, suggests that some kind of specialization in expertise of judges and bankruptcy practitioners does pay off. Presence of a specialized bankruptcy court (in middle-income countries) or a specialized commercial section in the general court (in low-income countries) are associated with faster and cheaper procedures and, therefore, better recovery rates. Requirements that judges and bankruptcy practitioners are trained specifically in bankruptcy law and practice and that they have some prior business experience also leads to better outcomes (World Bank-IFC 2005).

Lessons from Trade-Offs in Bankruptcy

There are a few uncontroversial policy prescriptions suited to the vast majority of EMEs seeking to improve their credit markets: allow an independent institution to create and manage a data bank with detailed information on assets and financial histories of firms; introduce international accounting standards to foster transparency; and focus on simplicity and speed in distress resolutions to minimize administrative involvement to the extent possible. Most of the existing evidence and modern economic theory suggest that in the periods between economic crises, creditor-controlled bankruptcies and simple liquidation procedures for all but the largest distressed firms serve the purposes of financial development better than more complex debtor-in-possession reorganizations.

Conclusion

Lowering the cost of capital for firms in emerging market economies is one of the major tasks of economic development. The key arguments we make are as follows.

First, in designing policies to attract capital, emerging market economies should look at the entire scope of corporate finance, including corporate governance and bankruptcy. Focusing just on minority shareholder rights, as is often argued in the policy debate, is misleading. Protecting entrepreneurs and large shareholders and creditors against expropriation is often a matter of primary importance. Ultimately stronger property rights will also benefit minority investors. The role of debt should not be ignored; commercial banks can play an important part in corporate governance. In more developed emerging markets, private equity funds also complement banks in monitoring and restructuring of corporations. In general, corporate governance reform and bankruptcy reform are highly complementary.

Second, optimal corporate governance and bankruptcy reforms in emerging market economies are unlikely to resemble those in OECD countries. Ownership and capital structures are different, as are the nature and the depth of markets. Government failures are also more prevalent in emerging market economies than in developed countries. Hence reforms require different priorities and different strategies for implementation. In particular, many EMEs have already adopted appropriate company and bankruptcy laws, but because of imperfect enforcement these changes have not yet had the desired effects on the cost of capital. In some circumstances, the transplantation of OECD laws that are not enforced or improperly enforced can be directly detrimental to financial development.

Third, there is substantial variation between emerging market economies, which implies that there is no "one-size-fits-all" solution. Implementation of reforms will depend crucially on the distribution of political and economic power in each particular country, as well as its cultural and social environment. Thus instead of suggesting ready solutions, this paper identifies the most important conceptual trade-offs in the areas of corporate governance and bankruptcy that can help inform policy debate about the costs and benefits of specific policy choices. The importance of these costs and benefits for each particular country would depend on its economic and political environment.

Fourth, corporate governance, bankruptcy, judicial, and political reforms are highly complementary in emerging market countries. One of the main obstacles to financial development—poor enforcement of law and contracts—is closely tied to weaknesses in political institutions. Improving enforcement requires policy intervention at many different levels, including deep political transformation with fundamental constitutional change, and administrative and regulatory reforms. Since the level of enforcement is necessarily an outcome of the political economic game between interest groups, improving enforcement is an immensely difficult task. Under poor contractual and law enforcement, private mechanisms of investor protection can help supplement private contracting and public law enforcement. However, private enforcement also relies on the quality of courts and public enforcement institutions. Ultimately, there is no short-cut to broad institutional development, and the design of policies to support corporate finance in a particular emerging market economy requires a deep understanding of the institutional context of that country.

Notes

1. Eaton and Kortum (2001) show that most of the world's capital is produced in a small number of research and development–intensive countries, while the rest of the world generally imports its equipment. In his influential paper, "Why Doesn't Capital Flow from Rich to Poor Countries?" Robert Lucas (1990) emphasizes the role of human capital and private incentives to accumulate human capital as a quantitatively important answer. His other explanations include expropriation and monopoly rents.
2. See also the survey by Durnev and others (2004) on the relative importance of country-specific versus firm-specific determinants of capital allocation in these countries.
3. Ironically in many countries, large firms and not small ones have softer bankruptcy de facto because of their greater clout in negotiations for government bailouts and "social" clauses in the legislation.

References

Ayotte, Kenneth. 2007. "Bankruptcy and Entrepreneurship: The Value of a Fresh Start." *Journal of Law, Economics, and Organization* 23 (1) (forthcoming).

Bartelsman, Eric, John Haltiwanger, and Stefano Scarpetta. 2004. "Microeconomic Evidence of Creative Destruction from Industrial and Developing Countries." Discussion Paper 1374, Institute for the Study of Labor (IZA), Bonn.

Beck, Thorsten. 2000. "Impediments to the Development and Efficiency of Financial Intermediation in Brazil." Working Paper 2382, World Bank, Washington, DC.

Berglof, Erik, and Patrick Bolton. 2002. "The Great Divide and Beyond—Financial Architecture in Transition." *Journal of Economic Perspectives* 16 (1): 77–100, Winter.

Berglof, Erik, and Mike Burkart. 2003. "European Takeover Regulation." *Economic Policy* 36: 172–213.

Berglof, Erik, and Anete Pajuste. 2003. "Emerging Owners, Eclipsing Markets? Corporate Governance in Central and Eastern Europe." In *Corporate Governance and Capital Flows in a Global Economy*, ed. P. K. Cornelius and B. Kogut, 267–304. New York: Oxford University Press.

Berkowitz, Daniel, Katharina Pistor, and Jean F. Richard. 2003. "The Transplant Effect." *American Journal of Corporate Law* 51 (1): 163–204.

Besley, Timothy, and Robin Burgess. 2004. "Can Labor Regulation Hinder Economic Performance? Evidence from India." *Quarterly Journal of Economics* 119 (1): 91–134.

Bolton, Patrick, and Howard Rosenthal. 2001. "Debt Moratoria, Bailouts and Bankruptcy." In *Defusing Default: Incentives and Institutions,* ed. M. Pagano, 77–115. Washington, DC: Inter-American Development Bank.

———. 2002. "Political Intervention in Debt Contracts." *Journal of Political Economy* 110 (5): 1103–34.

Bonin, John, and Mark Schaffer. 2002. "Revisiting Hungary's Bankruptcy Episode." In *Designing Financial Systems in Transition Economies: Strategies for Reform in Central and Eastern Europe,* ed. A. Meyendorf and A. Thakor, 59–100. Cambridge, Mass.: MIT Press.

Boycko, Maxim, Andrei Shleifer, and Robert Vishny. 1995. *Privatizing Russia*. Cambridge, Mass.: MIT Press.

Boyreau-Debray, Genevieve, and Shang-Jin Wei. 2005. "Pitfalls of a State-Dominated Financial System: The Case of China." Working Paper 11214, National Bureau of Economic Research, Cambridge, Mass.

Breach, Alasdair, Peter Boone, Eric Friedman, and Simon Johnson. 2000. "Corporate Governance in the Asian Financial Crisis." *Journal of Financial Economics* 58: 141–86.

Brown, David, John Earle, and Almos Telegdy. 2006. "The Productivity Effects of Privatization: Longitudinal Estimates from Hungary, Romania, Russia, and Ukraine." *Journal of Political Economy* 114: 61–99.

Burkart, Mike, and Fausto Panunzi. 2006. "Takeovers." Finance Working Paper 118, European Corporate Governance Institute (ECGI), Brussels.

Caselli, Francesco. 2005. "Accounting for Cross-Country Income Differences." In *Handbook of Economic Growth,* ed P. Aghion and S. Durlauf, 679–741. Amsterdam: North-Holland.

Chandler, Alfred. 1962. *Strategy and Structure: Chapters in the History of the Industrial Enterprise*. Cambridge, Mass.: MIT Press.

———. 1977. *The Visible Hand: The Managerial Revolution in American Business*. Cambridge, Mass.: Harvard University Press.

———. 1990. *Scale and Scope: The Dynamics of Industrial Capitalism.* Cambridge, Mass.: Harvard University Press.

Claessens, Stijn. 2003. "Corporate Governance and Development." Focus 1. Washington, DC: Global Corporate Governance Forum. http://www.gcgf.org/library/Discussion_Papers_and_Focus%20Notes/Focus_1_Corp_Governance_and_Development.pdf.

Cristini, Marcela, Ramiro Moya, and Andrew Powell. 2001. "The Importance of an Effective Legal System for Credit Markets: The Case of Argentina." In *Defusing Default: Incentives and Institutions*, ed. M. Pagano, 119–56. Washington, DC: Inter-American Development Bank.

Desai, Mihir, Alexander Dyck, and Luigi Zingales. 2004. "Theft and Taxes." Working Paper W10978, National Bureau of Economic Research, Cambridge, Mass.

Djankov, Simeon, Caralee McLiesh, and Andrei Shleifer. 2006. "Private Credit in 129 Countries." *Journal of Financial Economics,* forthcoming.

Doidge, Craig, Andrew Carolyi, and Renje Stulz. 2004. "Why Do Countries Matter so much for Corporate Governance." Working Paper 10726, National Bureau of Economic Research, Cambridge, Mass.

Du, Julan, and Chenggang Xu. 2005. "Legal versus Administrative Governance: Chinese Financial Market Regulation." Chinese University of Hong Kong.

Durnev, Art, and Han Kim. 2005. "To Steal or Not to Steal: Firm Attributes, Legal Environment, and Valuation." *Journal of Finance* 60 (3): 1461–94.

Durnev, Art, Kan Li, Randall Morck, and Bernard Yeung. 2004. "Capital Markets and Capital Allocation: Implications for Economies in Transition." *Economics of Transition* 12 (4): 593–634.

Dyck, Alexander. 2002. "The Hermitage Fund: Media and Corporate Governance in Russia." Case N2-703-010, Harvard Business School.

Dyck, Alexander, Natalya Volchkova, and Luigi Zingales. 2005. "The Corporate Governance Role of the Media: Evidence from Russia." Working Paper 54, Center for Economic and Financial Research (CEFIR), Moscow.

Eaton, Jonathan, and Samuel Kortum. 2001. "Trade in Capital Goods." *European Economic Review* 45 (7): 1195–1235.

Faccio, Mara, Ronald Mazulis, and John McConnell. 2006. "Political Connections and Corporate Bailouts." American Finance Association (AFA) 2006 Boston Meetings Paper.

Friebel, Guido, and Sergei Guriev. 2005. "Earnings Manipulations and Incentives in Firms." Working Paper 55, Center for Economic and Financial Research (CEFIR), Moscow.

Fuentes, Rodrigo, and Carlos Maquieira. 2001. "Why Borrowers Repay: Understanding High Performance in Chile's Financial Market." In *Defusing Default: Incentives and Institutions*, ed. M. Pagano, 189–223. Washington, DC: Inter-American Development Bank.

Garcia, Alvaro, Andrea Repetto, Sergio Rodriguez, and Rodrigo Valdes. 2003. "Concentration, Hold-up and Information Revelation in Bank Lending: Evidence from Chilean Firms." Working Paper 226, Central Bank of Chile, Santiago.

Glaeser, Edward, Simon Johnson, and Andrei Shleifer. 2001. "Coase versus the Coasians." *Quarterly Journal of Economics* 116 (3): 853–99.

Goriaev, Alexei, and Konstantin Sonin. 2005. "Is Political Risk Company Specific? The Market Side of the Yukos Affair." Discussion Paper 5076, Center for Economic Policy Research (CEPR), London.

Gourevitch, Peter, and James Shinn. 2005. *Political Power and Corporate Control: The New Global Politics of Corporate Governance.* Princeton, NJ: Princeton University Press.

Gourinchas, Pierre-Olivier, and Olivier Jeanne. 2006. "The Elusive Gains from International Financial Integration." *Review of Economic Studies* 73 (3): 715 –41.

Gupta, Nandini. 2005. "Partial Privatization and Firm Performance." *Journal of Finance,* 60 (2): 987–1015.

Guriev, Sergei, Olga Lazareva, Andrei Rachinsky, and Sergei Tsoukhlo. 2003. "Corporate Governance in Russian Firms." Working Paper 32, Center for Economic and Financial Research (CEFIR), Moscow.

Hart, Oliver. 1995. *Firms, Contracts and Financial Structure*. Oxford: Oxford University Press.

Hausman, Ricardo, Dani Rodrik, and Andres Velasco. 2005. "Growth Diagnostics." John F. Kennedy School of Government, Harvard University.

Holmstrom, Bengt, and Steven Kaplan. 2003. "The State of U.S. Corporate Governance: What's Right and What's Wrong?" *Journal of Applied Corporate Finance* 15 (3): 8–20.

Jensen, Michael. 2005. "Agency Costs of Overvalued Equity." *Financial Management* 34 (1): 5–19.

Johnson, Simon, John McMillan, and Christopher Woodruff. 2002. "Courts and Relational Contracts." *Journal of Law, Economics and Organization* 18 (1): 221–77.

Kaplan, Steven, Frederic Martel, and Per Stromberg. 2004. "How Do Legal Differences and Learning Affect Financial Contracts?" Research Report Series Paper 28, Swedish Institute for Financial Research (SIFR), Stockholm.

Khanna, Tarun, and Yishay Yafeh. 2005. "Business Groups in Emerging Markets: Paragons or Parasites?" Finance Working Paper 92/2005, Ecole Supérieure de Génie Informatique (ESGI), Paris.

Khwaia, Asim, and Atif Mian. 2005. "Do Lenders Favor Politically Connected Firms? Rent Provision in an Emerging Financial Market." *Quarterly Journal of Economics* 120 (4): 1371–1411.

King, Robert, and Ross Levine. 1993. "Finance and Growth: Schumpeter Might be Right." *Quarterly Journal of Economics* 108 (3): 717–37.

Kranton, Rachel. 1996. "Reciprocal Exchange: A Self-Sustaining System." *American Economic Review* 86 (4): 830–51.

La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer. 2006. "What Works in Securities Laws?" *Journal of Finance* 61 (1): 1–32.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny. 1997. "Legal Determinants of External Finance." *Journal of Finance* 53 (3): 1131–50.

———. 1998. "Law and Finance." *Journal of Political Economy* 106 (6): 1113–55.

———. 2000. "Investor Protection and Corporate Governance." *Journal of Financial Economics* 58 (1–2): 3–28.

Lambert-Mogiliansky, Ariane, Konstantin Sonin, and Ekaterina Zhuravskaya. 2003. "Capture of Bankruptcy: Theory and Russian Evidence." Working Paper 38, Center for Economic and Financial Research (CEFIR), Moscow.

Levine, Ross. 2005. "Finance and Growth: Theory and Evidence." In *Handbook of Economic Growth,* ed. P. Aghion and S. Durlauf, 865–934. Elsevier: North-Holland.

Liu, Qiao. 2005. "Corporate Governance in China: Current Practices, Economic Effects, and Institutional Determinants." Working Paper 1125, Hong Kong Institute of Economics and Business Strategy (HIEBS), Hong Kong.

Lucas, Robert. 1990. "Why Doesn't Capital Flow from Rich to Poor Countries?" *American Economic Review* 80 (2): 92–96.

Megginson, William. 2005. *The Financial Economics of Privatization*. Oxford University Press.

Miller, Marcus, and Joseph Stiglitz. 1999. "Bankruptcy Protection against Macroeconomic Shocks: The Case for a Super Chapter 11." Centre for the Study of Globalisation and Regionalisation, University of Warwick.

Mitchell, Janet. 1998. "Bankruptcy Experience in Hungary and the Czech Republic." Working Paper 211, William Davidson Institute, University of Michigan.

Monge-Naranjo, Alexander, Javier Cascante, and Luis Hall. 2001. "Enforcement, Contract Design and Default: Exploring the Financial Markets of Costa Rica." In *Defusing Default: Incentives and Institutions*, ed. M. Pagano, 225–69. Washington, DC: Inter-American Development Bank.

Ostberg, Per. 2005. "Disclosure, Investment and Regulation." Paper prepared for the European Finance Association (EFA) 2005 meeting, August 24–27, Moscow.

Pinheiro, Armando, and Celia Cabral. 2001. "Credit Markets in Brazil: The Role of Judicial Enforcement and Other Institutions." In *Defusing Default: Incentives and Institutions*, ed. M. Pagano, 157–88. Washington, DC: Inter-American Development Bank.

Pistor, Katharina. 2005. "Who is Tolling the Bells to Firms? Tales from Transition Economies." Columbia Law School.

Pistor, Katharina, and Chenggang Xu. 2005. "Governing Emerging Stock Markets: Legal vs. Administrative Governance." *Corporate Governance: An International Review* 13 (1): 5–10.

Ponomareva, Maria, and Ekaterina Zhuravskaya. 2004. "Federal Tax Arrears in Russia: Liquidity Problems, Federal Redistribution, or Regional Protection?" *Economics of Transition* 12 (3): 373–98.

Rajan, Raghuram, and Luigi Zingales. 1998. "Financial Dependence and Growth." *American Economic Review* 88 (3): 559–86.

Scharfstein, David, and Jeremy Stein. 2000. "The Dark Side of Internal Capital Markets: Divisional Rent-Seeking and Inefficient Investment." *Journal of Finance* 55 (6): 2537–64.

Schiller, Robert. 2003. *The New Financial Order: Risk in the 21st* Century. Princeton, NJ: Princeton University Press.

Schoar, Antoinette. 2002. "Effects of Corporate Diversification on Productivity." *Journal of Finance* 57 (6): 2379–2403.

Skeel, David. 2004. "The Anatomy of Corporate Law: A Comparative and Functional Approach" (book review). Yale University School of Law.

Shleifer, Andrei, and Lawrence Summers. 1988. "Breach of Trust in Hostile Takeovers." In *Corporate Takeovers: Causes and Consequences*, ed. A. Auerbach, 33–68. Chicago: University of Chicago Press.

Shleifer, Andrei, and Robert Vishny. 1992. "Liquidation Values and Debt Capacity: A Market Equilibrium Approach." *Journal of Finance* 47 (4): 1343–66.

———. 1997. "A Survey of Corporate Governance." *Journal of Finance* 52 (2): 737–83.

Stiglitz, Joseph, and Andrew Weiss. 1981. "Credit Rationing in Markets with Imperfect Information." *American Economic Review* 71 (3): 393–410.

Straub, Stephane, and Horacio Sosa. 2001. "Ensuring Willingness to Repay in Paraguay." In *Defusing Default: Incentives and Institutions*, ed. M. Pagano, 271–318. Washington, DC: Inter-American Development Bank.

Stulz, Rene. 2005. "The Limits of Financial Globalization." Working Paper 11070, National Bureau of Economic Research, Cambridge, Mass.

Tian, Lihui. 2005. "Bank Lending, Corporate Governance and Government Ownership in China." Guanghua School of Management, Beiijing University.

Tirole, Jean. 2001. "Corporate Governance." *Econometrica* 69 (1): 1–35.

Townsend, Robert. 1995. "Financial Systems in Northern Thai Villages." *Quarterly Journal of Economics* 110 (4): 1011–46.

Visaria, Sujata. 2006. "Legal Reform and Loan Repayment: The Microeconomic Impact of Debt Recovery Tribunals in India." Working Paper 157, Institute for Economic Development (IED), Boston University.

Volkov, Vadim. 2004. "The Selective Use of State Capacity in Russia's Economy: Property Disputes and Enterprise Takeovers, 1998–2002." In *Creating Social Trust in Post-Socialist Transition,* ed. J. Kornai, B. Rothstein, and S. Rose-Ackerman, 126–47. New York: Palgrave-Macmillan.

World Bank-IFC (World Bank and International Finance Corporation). 2004. *Doing Business 2004. Understanding Regulation.* A copublication of the World Bank, the International Finance Corporation, and Oxford University Press. The International Bank for Reconstruction and Development / The World Bank. http://www.doingbusiness.org

World Bank-IFC (World Bank and International Finance Corporation). 2005. *Doing Business 2005. Removing Obstacles to Growth.* A copublication of the World Bank, the International Finance Corporation, and Oxford University Press. The International Bank for Reconstruction and Development / The World Bank. http://www.doingbusiness.org

Zingales, Luigi. 1998. "Corporate Governance." In *The New Palgrave Dictionary of Economics and the Law*, ed. P. Newman, 497–503. New York: Macmillan.