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Center for the Economic Analysis of Law

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World Development Report

FROM PLAN TO MARKET

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Box 5.1 No loans for movable property?

Businesses in established market economies rely on movable capital: it accounts for about half of the private nonresidential capital stock and about three-quarters of corresponding gross investment. Yet private lenders in most transition economies are reluctant to make loans when the only collateral offered is movable property held by the borrower—tractors, livestock, inventory, machinery, or, in extreme cases, cars and trucks. Rather, lenders require that the movable properties be placed under their direct control—as if they were valuables in a bank vault or goods in a bonded warehouse—or that the borrower offer other types of collateral, such as real estate. This difficulty in using movable property as collateral results in much presumably desirable investment going unfinanced. Capital formation is slowed, resulting in lower output and growth. Why is real estate or merchandise in a vault acceptable as collateral, but not livestock, machinery, and inventories? The answer lies in the process of creating, prioritizing, and enforcing security interests in movable property—the underlying contracts necessary for loans and credit sales to work.

Creation. Legal systems should ideally permit the inexpensive creation of security interests for any person over any thing. Yet many transition economies restrict the development of such interests. Bulgaria and Estonia forbid the pledging of goods not currently held by the borrower, making it difficult to finance crops and livestock. In Hungary and Poland only banks may formally lend for property that remains in the borrower's hands; this limits development of nonbank lending. Vietnam forbids the sale of pledge items, making it difficult to finance inventory.

Determining priority. For pledging to work, lenders need a cheap and easy way to determine whether a prior security interest exists against the property offered as collateral. Some advanced legal systems do this by maintaining a publicly accessible registry; others do it less formally. Lenders in transition economies, however, cannot easily determine whether such security interests exist. In Bulgaria the priority of a security interest is determined by the date it is agreed to; without a central registry, this can only be uncovered by searching through hundreds of scattered notarial records. The pledge registry in Poland is open only to banks. In China and Lithuania a security interest in movable property can only be registered if the underlying asset requires registration—fine for cars, trucks, ships, and airplanes but useless for tractors, drill presses, and grain silos. In Latvia and Poland state taxes take automatic priority over secured private claims, so private lenders without intimate knowledge of the status of a borrower's tax payments cannot know if a loan is safe.

Enforcement. In the event of nonpayment, lenders also need a quick and inexpensive way to recover and sell pledged and mortgaged assets. In transition economies the time required for repossession and sale of a pledged asset ranges from six months to three years and can extend even longer. This is too long for most collateral to retain its economic value. Inventories of food, clothing, and even machinery will depreciate so much during this period that they cannot effectively guarantee a loan. Recent Russian and Chinese laws take some promising steps to address this problem, but it is too early to tell how well they are working.

legal frameworks for private sector development and judicial institutions are based primarily on Gray and Associates 1993 and on the Pistor background paper. Box 5.1 was prepared by Heywood Fleisig. For further discussion, see the Fleisig, Simpson, and Röver background paper. The study on contracting in Bulgaria is in Koford and Miller 1995. Box 5.2 is drawn from Black, Kraakman, and Hay 1996. CEE and NIS experiences in developing bankruptcy legislation are described in Balcerowicz, Gray, and Hashi forthcoming, Coates and Mirsky 1995, and Gray, Schlorke, and Szanyi forthcoming. For further discussion of market infrastructure see the background paper by Ickes and Ryterman. The discussion of the Chinese legal profession is from Alford 1995; for Vietnam, see Pham Van Thuyet 1995.

The cross-country research on economic growth and government credibility is described in Borner, Brunetti, and Weder 1994. The sections on crime and corruption in transition economies draw on studies of private firms cited in De Melo and Ofer 1995, Stone and Novitzky 1993 and 1995, and Webster 1994, as well as Keh 1994 and information provided by the United Nations Drug Control Programme. Mauro 1995 explores the relationship between corruption and growth. For more on the Russian mafia, see Handleman 1995. The workings of the Sicilian mafia are described in Stille 1995. Susan Rose-Ackerman helped prepare Box 5.3, which draws on Rose-Ackerman 1978 and Thacher 1995.

Chapter 6

The discussion on the legacies in the financial system in centrally planned economies is based on many sources but draws in particular on Bonin and Mizsei 1995, Gorton and Wilton 1996, Kornai 1992, and McKinnon 1991. General references on financial reform in transition economies, used in various places throughout the chapter, are Bonin and Székely 1994, Borish, Long, and Noël 1995, Calari and Pinto 1995, Caprio 1995, Caprio, Folkerts-Landau, and Lane 1994, Dittus 1994a and 1994b, Pohl and Claessens 1994, Saunders and Walter 1991, and Varhegyi 1995. General macroeconomic developments affecting the financial system are discussed in the De Melo, Denizer, and Gelb background paper.

General background on the importance and role of the financial system is provided in World Bank 1989. Evidence on the relationships between financial system development and economic growth and adjustment comes from King and Levine 1993a and 1993b. Evidence on the importance of central bank independence is provided in Alesina and Summers 1993 and Fischer 1995. The complementary relationships between banks, nonbank financial intermediaries, and capital markets—at the macroeco-

omic level and at the individual firm level—is discussed and evidence provided in Demirgüç-Kunt and Levine forthcoming, Demirgüç-Kunt and Maksimovic forthcoming, and Singh 1995.

The typology of approaches to banking reform in transition economies draws on the general references mentioned above. Box 6.1 draws on Pohl 1995a and 1995b and Pohl and Claessens 1994. Box 6.2 draws on Baer and Gray 1996, Bakker 1993, and the Gray background paper. The Claessens background paper compares the progress in institutional capacity building in transition economies and the relationship between bank quality and the structural characteristics of these economies. The paper was based on a survey of experts in the World Bank on the quality of banks in twenty-five transition economies and five comparator countries, dividing banking systems into “better” and “worse” segments. The background paper also provides evidence about the effects on bank quality in transition economies of more liberal entry, the role of banking regulation, and intervention in troubled banks.

The discussion of problem banks and the occurrence and resolution of banking crises is based on Baer and Klingebiel 1994, Caprio and Klingebiel forthcoming, Caprio and Vittas forthcoming, Delyagin 1995, Hansson 1995, and Hausmann and Gavin 1995. Principles for restructuring problem banks are further discussed in Sheng 1996 and World Bank 1995a. The role of banking supervision is further discussed in World Bank 1989.

The discussion on the different models of debt restructuring draws on Begg and Portes 1993, Caprio and Levine 1994, Levine and Scott 1993, and van Wijnbergen 1992 and 1994. The evidence on bank recapitalization is reviewed in Baer and Gray 1996, Caprio and Klingebiel forthcoming, and World Bank 1995a. The section on deposit insurance draws on Caprio and Vittas forthcoming and Glaessner and Mas 1995. The discussion of the issues of universal banks and banks owning shares in enterprises is based on Coffee 1995, Caprio, Folkerts-Landau, and Lane 1994, Dittus and Prowse 1996, and Walter 1993.

Lessons on the benefits and costs of development banks and directed credit were derived from Vittas and Cho 1995, World Bank 1989, and World Bank 1995f. The discussion of creating rural finance is based on the Brooks, Burcroff, and Lerman background paper and Laura Tuck's research on best practices. The example and discussions of housing finance draw on Lea and Renaud 1995 and Renaud 1996.

The discussion of nonbank finance is in part based on Calari and Pinto 1995. The section on leasing and venture funds draws on Kuczynski, Barger, and Carter forthcoming (a) and forthcoming (b). The capital markets section draws

tion with the European Union draws on Faini and Portes 1995, Hoekman and Djankov 1995, and Winters and Wang 1994. The discussion on integration into the European Union draws on Baldwin 1994, Bofinger 1995, and CEPR 1992. The discussion on capital flows draws from Brau 1995, Eichengreen and Uzan 1992, and the Kaminski and Wang background paper, which also gives net official capital inflows by country. The information on integration into the European Union is provided by the Commission of the European Communities 1995a, 1995b, and 1995c. Data on trade are from Eurostat data bases such as EEC External Trade and from the IMF's *Direction of Trade Statistics 1995*, and the United Nations COMTRADE data base. Data on capital flows come from, among others, World Bank 1994d and 1996b.

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