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Economics of Transition / Volume 8, Issue 2 / pp. 325-368

Law and Finance in Transition Economies

Katharina Pistor, Martin Raiser, Stanislaw Gelfer

First published: 10 January 2003

https://doi.org/10.1111/1468-0351.00047

PDF

Abstract

This paper offers the first comprehensive analysis of legal change in the protection of shareholder and creditor rights in transition economies and its impact on the propensity of firms to raise external finance. Following La Porta *et al.* (1998), the paper constructs an expanded set of legal indices to capture a range of potential conflicts between different stakeholders of the firm. It supplements the analysis of the law on the books with an analysis of the effectiveness of legal institutions. Our main finding is that the effectiveness of legal institutions has a much stronger impact on external finance than does the law on the books, despite legal change that has substantially improved shareholder and creditor rights. This finding supports the proposition that legal transplants and extensive legal reforms are not sufficient for the evolution of effective legal and market institutions.

Citing Literature

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