

# **Creating Collateral: Markets, Networks, and the Political Economy of Legal Reform**

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**Abstract:** It is widely understood that the operation of markets requires supporting legal structures. In their absence, trade is restricted to relational contracting within networks. This paper develops a model of contracts and matching of producers and suppliers to characterize the equilibrium in an economy where trade is relational and markets are fragmented. In this setting we study the effects of introducing a legal system that permits anonymous or arms length trading between any two producers and suppliers, distinguishing between partial equilibrium (contracting) and general equilibrium (re-matching) effects. We also analyze how economic and political factors interact in the political economy of legal reform.