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Access to Credit

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This year's Nobel Peace Prize winner, economist, and founder of the Grameen Bank, Muhammad Yunus, argues that credit is vital for relieving poverty. Credit allows households to borrow against future income and firms to invest, for instance, in machinery and equipment. However, a large part of the world lives in poverty, lacking access to credit. Some, including Yunus, maintain that a country's institutions directly affect the availability of credit.[1] How strongly does the availability of credit correlate with the institutional framework in which lenders and borrowers operate?

The World Bank's Doing Business project quantifies business regulations and their enforcement for 175 countries; it uses indices for ten categories of characteristics that facilitate entrepreneurship and ranks countries by their performance.[2] One of these categories, Getting Credit, measures the ease with which a country's institutions facilitate lending to entrepreneurs.

Economic theory implies that lenders make more loans if they have good information about borrowers and effective legal recourse to protect their interests in case of defaults. The "legal rights index" measures the ability of lenders to protect their interests, granting a point for each attribute in a country's legal system that facilitates the writing and enforcement of credit contracts. These attributes include the legal granting of security in a property, the priority of secured creditors in a bankruptcy filing, and the use of the contract to seize and sell collateral without judicial intervention.

Similarly, the database compiles a second set of measures on the availability of information on the creditworthiness of borrowers in each country (columns 3 through 5). The "credit information index" (column 3, 0 to 6 scale) measures, e.g., whether information is based on at least two years of history and whether it is made available from retailers and utilities in addition to financial institutions. The extent to which credit information covers the population is measured separately for public credit registries (column 4) and for private credit bureaus (column 5). Even an efficient and reliable credit information system is of little use if it covers only 10 percent of the population. Notice that while public registries cover little of the top five countries, private credit bureaus cover most or all of the country. For a given country, the Getting Credit rank (column 1) reflects the simple average of the percentile rankings of the four variables in columns 2 through 5.

In column 7, private credit-to-GDP ratios are at least three times as high for the countries with the highest credit rankings, compared with those with the lowest credit rankings. However, a high correlation between higher rankings and a greater supply of credit does not, by itself, prove causation. For example, countries where credit is more readily available might be more likely to create credit-facilitating institutions. Or a third factor, such as GDP per capita (column 6), could cause both. Still, recent research argues that legal and informational characteristics that facilitate loan contracting encourage the availability of credit,[3] which is important for economic development. ■

[1] http://nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-lecture-en.html.

[2] For details on each category and the methodology used to rank countries, visit www.doingbusiness.org.

	Getting Credit						
Country	Rank	Legal rights index	Credit information index	Public registry coverage (% adults)	Private bureau coverage (% adults)	GDP per captia ($ PPP)	Private credit/ GDP ratio
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Top 5							
United Kingdom	1	10	6	0	86.1	30,436	1.63
Hong Kong, China	2	10	5	0	64.5	33,479	1.46
New Zealand	3	9	5	0	100	24,797	1.35
Australia	3	9	5	0	100	30,897	1.08
Germany	3	8	6	0.5	93.9	30,579	1.12
Bottom 5							
Rwanda	159	1	2	0.2	0	1,380	0.01
Egypt	159	1	2	1.5	0	4,317	0.32
Burundi	159	2	1	0.1	0	739	0.19
Lao PDR	173	2	0	0	0	2,118	0.00
Cambodia	174	0	0	0	0	2,399	0.09

SOURCE: *doingbusiness.org* (World Bank), *International Financial Statistics*, and IMF *World Economic Outlook Database 2005*.