Which Creditors' Rights Drive Financial Deepening and Economic Development?

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Abstract

Since the 1990s financial economists have documented the essential role of creditors' rights in encouraging lenders to provide credit. This article demonstrates the central importance of creditors' ability to use movable assets such as inventories and accounts receivable (as distinct from immovable assets like real estate) as collateral when lending to business enterpriseses. Using a unique cross■country, micro■level loan data set that contains loan■to■value ratios for different assets, the authors found that the loan■to■values of loans that are collateralized with movable assets were lower in countries with weak collateral laws for movable assets, and that lending in such countries was biased toward the use of immovable assets. Using sector■level data, the authors also found that weak movable collateral laws were associated with distortions in the allocation of resources that favored immovable■based production and investment. The effects of resources that favored immovable■based production and investment. The effects of the collateral law reform enacted in Slovakia in 2003 were held up as providing support for the authors' findings.The authors also investigated which aspects of movable assets collateralization regimes are most important for facilitating the use of movable assets as collateral. They concluded that the two critical features of such regimes are the registration of collateral interests—which facilitates monitoring of collateral and avoids double pledging—and the ability of creditors to avoid lengthy court proceedings when taking possession of collateral. These findings suggest that it would be relatively easy for many countries to increase their supply of credit because reforming these aspects of legal regimes is fairly straightforward with few political obstacles..