

## **I. INTRODUCTION**

1. This paper surveys and compares the framework for security interests in movable property—the legal framework for secured transactions—in five RETA countries: the People’s Republic of China (PRC), India, Indonesia, Pakistan, and Thailand. Its legal findings rest on an analysis of laws and legal secondary sources undertaken by both international and national experts in security interests. This legal research, together with basic economic findings on the importance of collateral to creditors and movable property to debtors, formed the basis for a series of Enterprise Interviews conducted in the five RETA countries. This research rests on deductions about the consequences of these legal provisions and on corroborating interviews with enterprises conducted by teams in the field. The economic consequences expected from the legal and economic research were borne out in the field interviews: Asian debtors face serious limits in their access to credit because Asian creditors must operate in a legal environment where they cannot effectively use movable property as collateral for their credit.

2. In Chapter II, the report presents the concept of secured credit. It identifies the parties to a secured transaction and explains several different ways in which the debtors and creditors in these transactions are important to policy makers. These affect the rules they write and administer for secured transactions. Secured transactions broadly defined take several legal forms, some of which may allow the parties to escape the rules governing those who are formally classified as secured debtors and creditors. This report extends to all types of security interest, regardless of legal form. The type of collateral it examines, however, is only movable property. To examine the use of land as collateral would require examination of a different body of law and enterprises, but this report does include fixtures, which are movable property attached to real estate.

3. Chapter III explains the economic logic for the key role collateral plays in leading private businesses and financial institutions to lend and sell on credit. Private markets in all countries rely on a combination of secured (with collateral) and unsecured (without collateral) lending and sales on credit. Basic economic behavior—credit rationing, asymmetric information, moral hazard, and adverse selection—lies at the root of the importance of collateral. Economic fundamentals dictate that all financial systems that cannot effectively use collateral also will not address the basic concerns of private creditors. Until those concerns are addressed, debtors will continue to face difficulties getting access to credit. They will receive small loans, at high interest rates, repayable in short periods of time, largely from creditors who know them well. Chapter III explains the key economic importance in production and trade of movable (or personal) property. It illustrates this importance with data from an advanced economy and presents analogous data for the five RETA countries. It then briefly reviews the economic gains that come from improving the regime for secured transactions. The economy benefits, for example, from the reduction in system-wide risk. Finally, it presents the reasons that reform of the regime for secured transactions will benefit the economy of the country.

4. The next five chapters explain why private creditors facing the legal systems of the five RETA countries will typically not accept the movable property that debtors offer as collateral for credit. The legal research pinpoints the precise elements of the laws of the five RETA countries that produce a legal environment in which private creditors cannot use collateral and, therefore, debtors cannot get access to credit. Chapter IV identifies the policy questions that must be resolved to achieve a regime for secured transactions that is economically useful. It presents the elements of a regime that is dedicated to promoting secured credit, through use of a baseline policy model to

examine the regimes in the five RETA countries. It also presents qualifications to such a baseline policy model. Finally, it explains the methodology and system of citation used in the report.

5. Each of the four succeeding chapters (Chapters V to VIII) examines one of the four key steps that determine the effectiveness of a system of secured credit:

- Creation: how creditors establish a claim to property to secure the payment of credit;
- Priority: how creditors establish a ranking of their claims in collateral;
- Publicity: how creditors make public the ranking of their priority in collateral; and
- Enforcement: how creditors repossess collateral and sell it for satisfying their claims.

6. In each chapter, brief explanation of the economic consequences of these legal problems accompanies each set of legal findings. The chapters show how the laws of these countries set out a costly, complex, lengthy, and uncertain process for securing credit with movable property. Facing this, private creditors mainly do not take such collateral from debtors. Debtors, in turn, have little access to credit unless they own real estate or can obtain the guarantee of someone else who owns real estate.

7. The paper then turns, in Chapter IX, to the economic consequences of this system. Using extensive Enterprise Interviews, conducted by the project across a broad range of debtors and creditors in the five RETA countries, the chapter examines how these legal problems hurt key groups of creditors and debtors and limit important financial transactions. It shows how the debtors and creditors indeed face the problems that the earlier chapters predict will arise from analysis of the law. These interviews examined the experience of financial institutions as creditors and of other enterprises that operate both as creditors and debtors: firms that deal in agricultural inputs, general merchandise, cars, heavy machinery, computers, and fixtures. The findings confirm the prediction of the legal research: financial firms rarely lend on the security of movable property not in their possession and non-financial enterprises usually offer relatively little secured credit to their buyers. None is able to refinance unsecured credit and accounts receivable, limiting in turn the ability of the unsecured lending sector—including micro-finance creditors—to refinance their portfolios. Finally, in Chapter X, this paper reviews the outlook for reform. It discusses the incentives for reform and sets out a brief review of options for reform, including a baseline policy approach, a possible counter-approach based on the literature, and factors that argue for the occasional derogation from the baseline policy model. It explains why only a strategy that addresses the legal roots of these problems will improve access to credit in a sustainable way. It points out how these same legal problems have undermined previous attempts at solutions that attempted using economic measures to compensate for these legal inadequacies.

## **II. SECURED CREDIT**

8. Secured credit is a concept that varies in scope in different countries. This chapter describes the phrase as used throughout the report, identifies the parties to the transactions, introduces the notion of the credit chain, identifies categories of secured transactions that are important to policy makers, and defines movable property (the type of collateral examined in this report).