

Does Business Formalization Improve Access to Credit?

Evidence from Iraqi Microenterprises

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The aim of the paper

The paper addresses a central question: *Does formalizing microenterprises truly improve their access to bank credit?*

Methodology & Data

The study empirically tests this hypothesis by applying an impact evaluation method: Propensity Score Matching (PSM) using Data from Iraq. This approach helps isolate the causal effect of formalization by controlling for selection bias based on observable firm characteristics.

The study draws on two separate surveys: one focused on informal microenterprises and the other on formal microenterprises. While it is noted that the sample is stratified, no information is provided regarding whether it was randomly selected.

Main results

The authors highlight a particularly important finding for public policy: formalization alone is not sufficient to ensure financial inclusion. Without complementary support measures, it does not significantly improve access to credit for microenterprises.

Main limitation

- 1. Data limitations (cross-sectional data):** The analysis relies on a single survey round, which prevents capturing dynamic effects or before/after comparisons. The author acknowledges this limitation, which is a positive point.
- 2. Causal interpretation issues:** access to credit may drive formalization (rather than result from it), or both may be simultaneously influenced by a third factor (government support or regulatory changes). Moreover, the effect of formalization may be heterogeneous across sectors, firm sizes, locations, or entrepreneur profiles, dimensions the paper does not explore in depth.
- 3. Censoring due to unobserved stages (application vs. approval):** the study does not distinguish between the decision to apply for a loan and the conditional approval. This censoring makes it difficult to determine whether lack of credit is due to non-application or rejection, which hampers accurate estimation of conditional probabilities.

4. Potential endogeneity: unobserved factors may simultaneously affect both the decision to formalize and access to credit. This structural endogeneity is not addressed by PSM, which only corrects for selection on observables and assumes conditional exogeneity.

Methodological recommendation : To strengthen causal identification, the authors could: Combine PSM with difference-in-differences (PSM-DiD) if panel data is available, or use an instrumental variable (IV) approach, provided a valid exogenous instrument for formalization can be identified.