THE MARKET FOR CREDIT By using a credit card, many of us borrow money without providing any collateral. Most credit cards allow the holder to run a debt of several thousand dollars, and many people hold several credit cards. Credit card companies earn money by charging interest on the debit balance. But how can a credit card company or bank distinguish high-quality borrowers (who pay their debts) from low-quality borrowers (who don't)? Clearly, borrowers have better information—i.e., they know more about whether they will pay than the lender does. Again, the lemons problem arises. Low-quality borrowers are more likely than high-quality borrowers to want credit, which forces the interest rate up, which increases the number of low-quality borrowers, which forces the interest rate up further, and so on.

In fact, credit card companies and banks *can*, to some extent, use computerized credit histories, which they often share with one another, to distinguish low-quality from high-quality borrowers. Many people, however, think that computerized credit histories invade their privacy. Should companies be allowed to keep these credit histories and share them with other lenders? We can't answer this question for you, but we can point out that credit histories perform an important function: They eliminate, or at least greatly reduce, the problem of asymmetric information and adverse selection—a problem that might otherwise prevent credit markets from operating. Without these histories, even the creditworthy would find it extremely costly to borrow money.