Discussion: Credit Allocation When Private Banks Distribute Government Loans

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November 2021

XXVI Meeting of the Central Bank Researchers Network

The views expressed are solely my own and do not necessarily represent the opinions of the Banco Central do Brasil

This paper

- Study bank lending when private banks distribute earmarked market characterized by government-funded loans

- Main findings
  - Banks are more likely to extend earmarked loans to larger firms and firms with existing relationships
  - A cross-selling strategy whereby banks increase the price of free-market loans for riskier borrowers that obtain earmarked credit

Comments

- The percentage and quality of collaterals earmarked loans is usually very high, and this may affect some insights of the paper, concerning risks of the borrowers and so on
  - E.g. riskier firms borrowing from a top-three bank have higher chance to of obtaining an earmarked loan simultaneously with a working capital loan and this is interpreted as finding as evidence of product cross-selling
- Many insights of the paper concern large banks.
  - It is not completely clear if these large banks are the top 3 or top 5

Suggestions

- Improve the comments on earmarked loans
  - E.g. Earmarked loans are considered a *premium credit* by the lender and by the borrower (cheap funding) and this may explain why banks are more likely to extend earmarked loans firms with existing relationships
- Compare the results with credit unions
  - they lend proportionally a lot earmarked credit, specially in some regions of Brazil
- As a robustness check, use the client risk rate available in the Brazilian credit registry

Overall

- Very good paper and relevant question