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The after crisis government-driven credit expansion in Brazil: A firm level analysis

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Government-driven credit had an important role in countervailing the private credit crunch in Brazil during the recent financial crisis. However, government credit concessions continued to expand after the economy recovered. This paper investigates some important features of this expansion using a huge repository of loan contracts between banks and firms, composing an unbalanced panel of almost 1 million firms between 2004 and 2012. Our results show that larger, older and less risky firms have benefited most from the government sponsored credit expansion. Additionally, although a higher access to earmarked credit tends to lead to higher leverage, the effect on investment appears to be insignificant for publicly traded firms. Since interest rates on earmarked loans are lower than market interest rates, firms with higher access to this type of loan tend to have lower cost of debt.

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1. Introduction

Government-driven credit expansion had an important role in countervailing the non-earmarked private credit crunch in Brazil triggered by the international financial crisis in 2007/2008. The Brazilian economy recovered fast, with a strong rebound in 2009. However, earmarked and government-owned banks credit concessions have not receded after the crisis, but continued to expand reaching

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much higher levels than the ones prevailing before the crisis (47.66% of total credit in December 2012, as compared to 34.27% in September 2008). This overall government-driven credit expansion raises concerns about its impact on the allocation of resources among sectors and firms, as well as on private banks credit allocation.

Government ownership of banks and regulation of private credit markets are pervasive around the world (see La Porta et al., 2002). One may take the social view that government intervention is justified whenever projects whose social benefits exceed their costs would not be funded if private markets were functioning without intervention (Atkinson and Stiglitz, 1980).[1] This definition encompasses two different cases. The first one is when credit market failures, caused by asymmetric information, prevent the funding of otherwise privately viable projects. The second is when social externalities make an unprofitable project socially desirable. The latter case could justify subsidizing the project, which may take many alternative forms. The concession of subsidized loans to boost the project's NPV is one of the most common ways to incentivize the implementation of projects with social externalities. Cyclical intervention in the credit market could also be justified, according to the macroeconomic view, by externalities in increasing credit during a crisis period.

Government intervention through state-ownership of banks and earmarked credit lines may fail to fulfill the role proposed by the social view due to incentive problems that are inherent to the public sector. State intervention may not maximize the social welfare because of agency costs within government bureaucracy (Banerjee, 1997; Hart et al., 1997), which may result in misallocation. At a more macro level, according to the political view, the incumbent government may purposely use its control of government-banks to distort its lending activity for political benefit (see evidence in Sapienza, 2004; Claessens et al., 2008; Carvalho, 2014).

In this study we investigate whether after the crisis government-driven banks' credit expansion in Brazil fulfilled the role proposed by the social view. In order to do so we use a huge repository of loan contracts between banks and firms, composing an unbalanced panel of almost 1 million firms between 2004 and 2012 from the Brazilian Public Credit Register[2] (CIS – Credit Information System, owned and managed by Central Bank of Brazil). We also combine the above data with accounting information available at Economatica for publicly traded firms in order to relate public credit policies with firms' investment and indebtedness decisions.

One clear limitation that we face in our analysis is that we do not observe when a firm is rationed or when a project generates social externalities. Thus, we have to rely on the statistical relationship between our observable variables in order to infer the answer to the question we pose.

For a given macroeconomic environment, market failures are more likely to affect firms with higher information asymmetry, among them those that are smaller, newer and more innovative. They are more likely to be credit constrained or to pay high interest rates. Small, new and innovative firms are arguably more likely to generate externalities, either by increasing competition or by generating technological spillovers. Thus, even if they have access to credit at high interest rates, government intervention in order to provide them with cheaper credit may be justified. Thus, earmarked and government-owned banks' credit could release the credit constraint facing small, new and innovative firms, or reduce their financial cost. In both cases, it should contribute to increasing the investment of the economy.

On the other hand, government-driven credit lines may be allocated to large firms in order to finance projects with social externalities that otherwise would not be implemented – infrastructure, for example. Then, those credit lines with lower interest rate would make those projects viable and lead to an increase in investment. Another possibility is that those subsidized loans are allocated to fund projects with no social externalities. Then, if a project is profitable with private funding, the investment would be undertaken anyway and the subsidized loan will only contribute to boosting the

[1] The optimal form of intervention could be the ownership of banks or regulation of the private market depending on the contractible nature of objectives (see Levy-Yeyati et al. 2004 for a detailed discussion).

[2] A confidential loan level database, protected by Brazilian banking privacy law, provides detailed information on all loans granted after January 2004, such as loan amount, loan maturity, interest rates and default rates. However it contains little borrower level information.

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