Are the Credit Guarantee Schemes Effective in Portugal?

Evidence from *PME Investe* Programme

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Summary

Guarantee schemes are widespread in both developed and developing countries, where they are currently seen as effective instrument for improving the firms' access to credit markets, especially for SMEs. Most of these schemes are publicly funded, and this policy approach is often recommended by international organisations (D'Ignazio and Menon, 2012). Although these initiatives are popular, economic theory has not yet determined their net effect on participating firms.

This dissertation empirically examines the effects of a broad government credit guarantee scheme on loan availability and the ex-post performance of firms. The programmes *PME Investe III* and *IV* are an excellent test case, because both were implemented on a large scale, for a limited period, and were uniformly available to almost all Portuguese SMEs. To measure their impact, this study relies on a unique set of panel data covering small firms and their liabilities to the financial sector. Using a difference-in-difference matching method, the paper evaluates the treatment effect of the policy on a number of potential outcome variables – such as the bank debt of each firm, its debt structure, its interest expenses, its profitability and the probability of default – for four years after joining the scheme.

The results have shown that this Portuguese CGS successfully mitigated the information asymmetries in the credit market, with programme participants experiencing an overall increase of credit in comparison to nonparticipants. More importantly, this growth continued after the programme ended, even during the severe contraction of credit lending to SMEs experienced in Portugal after 2011. The programme also helped

participants to reduce their short-term debt needs and their interest expenses. The results showed that the policy led to a statistically significant increase in the proportion of long term debt, and that treated firms were able to renegotiate their debt structure even after the guarantees ceased. The introduction of this scheme also led to lower interest rates for the beneficiary firms, achieving one of the main aims of the policy.

The design of the scheme also contributed to reducing the moral hazard among borrowers. All loans granted were partially guaranteed by a public institution, splitting the risk between the bank and the state. This design seemed to encourage careful assessment and monitoring of the participants' performance, reducing the overall probability of default. This was particularly important for the Portuguese financial system, helping the banks to reduce their risk-weighted exposures, and therefore to improve their capital ratios under the Basel Accord.

Moreover, there is also statistical evidence of economic spillover effects. The treated firms experienced a positive and significant difference regarding employment growth, turnover, exports and net value in comparison to the control group. However, there is no evidence that the programme helped the participants to find and invest in more profitable projects. This suggests that further mechanisms should be implemented, such as controlling the type of investments that these loans can be used for, to improve the overall performance of these firms.

In a similar vein, these effects were not homogenous across firms differing in size and credit. The design and features of the scheme were slightly different between programmes; these differences allowed the magnitude of the effects to be distinguished among different kinds of firms programmes. The credit line directed to exporters (EXP Programme) had limited effects among medium-sized firms, suggesting that the programme design should be reshaped for these entities. Moreover, although the programme directed to smaller firms (SME Programme) increased the overall level of credit,

there is also statistical evidence that the participant firms reduced their international transactions, such as their volume of exports.

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