



Research Working Papers

Credit Guarantee and Fiscal Costs

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A government guarantee on infrastructure investment can raise non-performing loans and dampen economic activity in the near term.

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This paper studies the effectiveness of government-backed credit guarantees to the infrastructure sector, a policy tool adopted by a range of countries during recessions. We propose a two-sector model with financial intermediary frictions so that infrastructure producers rely on bank loans to finance their risky production. Governments can intervene in the credit market by providing a partial guarantee on those bank loans. We find that a credit guarantee increases infrastructure production, leading to a high fiscal multiplier in the longer run. In the near term, however, higher wages in the infrastructure sector crowd out labor supply in the private sector, dampening economic activity. Importantly, the higher leverage associated with credit expansion raises non-performing loans, and this channel is particularly pronounced if the government-backed credit guarantee lingers for a long period of time.

JEL classifications: E62, E44

Article Citations

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Related Research

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- Chang, Chun, Zheng Liu, Mark M. Spiegel, and Jingyi Zhang, 2019. "Reserve Requirements and Optimal Chinese Stabilization Policy." *Journal of Monetary Economics*, vol. 103, pp. 33–51. Available at <https://doi.org/10.1016/j.jmoneco.2018.08.005>

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