Research Working Papers

Loan Guarantees in a Crisis: An Antidote to a Credit Crunch

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By providing small and midsized firms with forgivable bank loans, the PPP offset declines in bank lending to businesses and protected banks against credit losses.

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Credit contractions are costly, but policymakers have limited tools to counter them. In this paper, we examine the efficacy of public credit guarantees as antidotes to a credit crunch by studying the Paycheck Protection Program (PPP). We find that the program averted a historic credit crunch at a time when banks were unlikely to meet firm credit needs by risking their own capital. Our evaluation incorporates selection effects emanating from banks' participation decision on both the extensive and intensive margins. Risk-aversion, rather than profitability, motivated bank participation in the program. Indeed, even as the program boosted loan growth among participants, it attenuated profitability.

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