



Special Series on Fiscal Policies to Respond to COVID-19

This is one of a series of notes produced by the Fiscal Affairs Department to help members address the COVID emergency. The views expressed in this paper are those of IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

Public Banks' Support to Households and Firms¹

Given the extraordinary circumstances of the Covid-19 pandemic, public banks—if financially sound and sufficiently well-resourced—can temporarily boost their support to households and firms, mainly through (subsidized) loans and loan guarantees. An advantage of public banks is their ability to reach large and small firms, as well as households and subnational governments. Several advanced and emerging market economies have already announced plans in this direction. Experience with the global financial crisis (GFC) shows that public bank loans and guarantees can be effective but involve fiscal risks and costs. It is necessary to ensure a high degree of transparency and a clear rationale for intervention, assess and disclose risks and costs, take risk mitigation measures, and make provisions in the budget.

Public banks are another policy tool to help contain the economic fallout from the pandemic.

Countries are adopting many fiscal, financial, and monetary policy measures given the severity of the shock. Public banks—if financially sound and sufficiently well resourced—can be used to complement these efforts especially in cases where private banks are reluctant to lend, even with government guarantees, given risks or operational costs. To support public policy objectives, public banks can:

- temporarily fill the gap from under-provision of credit by private banks in times of crisis by providing guarantees or loans, including at subsidized rates. This is especially helpful to vulnerable groups, such as small and micro enterprises and self-employed, which are unlikely to get affordable loans otherwise. This will provide relief to firms and households to service or rollover debt and pay for wages, rents, or utilities. Public banks (or other public financial institutions) can also be used to manage the governments' loan guarantee programs.

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- provide support, including loans and equity, to large, strategic firms that face severe financing constraints due to the health and economic costs of the outbreak.²
- support private bank funding—including by onlending operations (providing loans via private banks)—and liquidity. Public banks can be perceived as safer than private banks in times of crisis, and sustain a more stable deposit base (public commercial banks) and capital market access.
- lend to local governments to address the health and economic impact of the pandemic.

Several countries are stepping up credit to the economy through their public commercial or development banks:

- In Germany, the federal government raised its guarantee framework to its development bank, KfW, by about €362 billion (total envelope of €822 billion) to facilitate loans to businesses and the self-employed. Italy is **supporting** the state development bank Cassa Depositi e Prestiti through a newly created Treasury fund to guarantee at least €10 billion in loans to SMEs. France **announced** guarantees of €300 billion for bank loans to affected firms, to be administered by a state-owned development bank, in addition to already **announced** plans to expand guarantees for small and medium-sized enterprise (SME) loans by the state-owned investment bank BPI. In Japan, the government launched ¥1.6 trillion financial support program primarily for micro businesses and SMEs through the Japan Finance Corporation and other institutions, which include unsecured interest-free loans to affected firms. The United Kingdom **launched** a Coronavirus Business Interruption Scheme administered by the state-owned British Business Bank (BBB), which provides lenders with a guarantee of 80 percent for loans of up to £1.2 million and a subsidy for interest payments. The European Investment Bank (EIB) has proposed a €25 billion pan-European credit guarantee, which is under discussion at the Eurogroup.
- Among emerging markets, Brazil's two large state-owned commercial banks, Caixa and Banco do Brasil, have announced a BRL150 billion expansion of credit lines to support local governments, SMEs, firms, and households affected by the corona crisis. Colombia's development bank, Bancoldex, will provide loans (onlend) to SMEs and self-employed. In Turkey, leading public deposit banks Ziraat Bank, Vakifbank, and Halkbank announced several measures, including: short-term interest-free delays in repayments of loans; the opportunity to restructure corporate loans with grace periods of up to six months (longer for tourism and transport firms); increased credit limits in general, and particularly for corporates that keep employees to pay wages. State-owned banks are also being used in South Korea to provide loans to hard-hit firms, including airlines. Saudi Arabia's Social Development Bank has approved a SR12 billion program to support SMEs and low-income families.

Past experience, including the global financial crisis (GFC), shows that action by public banks can be effective but also involves fiscal risks and costs. During the GFC, public commercial and development banks were used in both advanced and developing economies to counter the private credit crunch and prop up the economy. Several countries injected capital into their public banks to rollover or expand credit to small businesses and exporters (Canada, Chile), large firms (Brazil), or the corporate sector (Poland). Others raised the credit ceilings of their public banks (Finland, Korea) or set up new credit facilities (India,

² See note on Public Sector Support to Firms.

Tunisia) and special guarantee programs (Mexico) for public banks to support key sectors. However, there are limits to their actions. Additional mandates require additional funding for public banks to preserve financial stability; but large capital injections or loans to public (especially development) banks can put pressure on the sovereign that already has high public debt. In addition, if public banks significantly scale up loans, the monitoring and assessment of risks—and governance more broadly—could weaken. This calls for a high degree of scrutiny of these exceptional and temporary operations.³

Support programs should be designed with appropriate safeguards and be transparent to ensure accountability and contain fiscal costs. The activities of public banks under these extraordinary conditions will inevitably involve complex and large risks. Any decision on using public banks should take into account implications for financial stability and public finances. To ensure financial stability, support programs should be appropriately funded and governments should stand ready to backstop the banks (including through recapitalizations). This argues for caution especially for governments that have large debt. Lessons from previous experience highlight the importance of creating safeguards to avoid undue political interference and ensure effective monitoring and transparency of these activities:⁴

- Governments should approve any financial support to public banks through the budget process and any quasi-fiscal support given by public banks should be costed and included in budget documents. More generally, governments should clarify rationale for intervention through public banks, assess potential fiscal costs and risks from measures (including covering losses of public banks), ensure mechanisms for central approval, and disclose all measures. For guarantees, governments should also quantify the size of risk and potential future fiscal costs, consider partial guarantees to limit exposure and risk-based guarantee charges, retain ability to recover assets, and make provisions for expected costs in the budget (see note on Managing Public Finances Risks Under Stress).
- Caution will be needed if the governance weaknesses at the public financial institutions are significant. This will demand creating mechanisms to ensure high degree of scrutiny of the decisions of public banks to ensure they are in line with public policy objectives and is done transparently and at arm's length. One possibility is using onlending (through private banks) and loan guarantees where credit assessments and decision making are left to the private sector.
- Appropriate corporate governance principles should be adopted, especially on risk reporting and internal controls to help keep the institutions focused and minimize losses. This should involve steps to ensure that credit decisions are made with a full understanding of the risk profile of the borrower as appraisal of collateral. Loan guarantees should be used as a risk alleviation tool but should not obviate the need for credit officers to appropriately originate viable loans. Banks should continue to adhere to prudential regulations and risk management practices as well as prudent loan classification and provisioning practices.⁵

³ See Spring 2020 Fiscal Monitor (forthcoming).

⁴ See also World Bank "Global Financial Development Report 2013: Rethinking the Role of the State in Finance"

⁵ See [note](#) on Regulatory and Supervisory Response to deal with Coronavirus Impact