

# The dark side of loan guarantee programs for SMEs

June 25 2024, by Valentina Gatti

---



Credit: Unsplash/CC0 Public Domain

There is always a downside. Even for loan guarantee programs for small businesses, launched during financial crises to stave off the drying up of credit, particularly likely in periods of recession. It turns out these

programs also have negative effects on the labor market, as is argued in the paper "The Labor Markets Effects of Loan Guarantee Programs," co-written by Jean-Noel Barrot (HEC Paris), Thorsten Martin, Julien Sauvagnat (both at the Bocconi University, Milan) and Boris Vallee (Harvard Business School).

The paper is [published](#) in the *SSRN Electronic Journal*.

The research study uses administrative microdata on French SMEs that made use of public loan guarantee programs from Bpifrance, a public investment bank that works with a network of French banks, in 2008–2009.

The study exploits geographic variations in the intensity of the loan guarantee program. In detail, thanks to the approach based on the discontinuity of regional borders, the authors of the paper estimate the causal impact of the program on the employment and wage trajectories of workers, comparing regions with different levels of exposure to the program, while at the same time taking local economic conditions and the characteristics of businesses into account.

The paper finds that the loan guarantee program significantly increased the employment and earnings of workers in beneficiary firms in the medium term (until 2015), leading to positive effects on aggregate employment and a reduction in [unemployment benefits](#). However, the program also had some unwanted and unanticipated effects: it reduced the mobility of workers, especially highly skilled and in-demand workers, preventing them from moving to more productive companies, as usually happens when a recession hits. This effect is particularly relevant for high-paid workers employed in highly sought-after professions and who perform intellectual and non-routine work.

This labor misallocation effect resulted in a reduction in aggregate

productivity and affected the trajectory of the post-recession economy, highlighting a trade-off between immediate employment benefits and long-term economic efficiency.

A cost-benefit analysis of the loan guarantee program highlights that the latter has brought positive revenues for the government, as well as savings on unemployment benefits, with an estimated positive impact of 270,000 jobs saved.

Given these findings, the study's authors say loan guarantee programs can be effective tools for preserving jobs during economic downturns and can have cost-effective results by reducing unemployment benefits. However, they also show that such programs could hinder the natural reallocation of labor towards more productive enterprises, particularly affecting highly [skilled workers](#).

Therefore, when designing loan guarantee programs, it is essential to consider mechanisms to support not only job retention but also labor mobility, to improve overall productivity and economic growth. Finding a balance between these goals can help achieve more sustainable economic outcomes. In general, such programs work best in areas with higher unemployment, where the workforce is not rigid and government budget constraints are more stringent.

**More information:** Jean-Noel Barrot et al, Employment Effects of Alleviating Financing Frictions: Worker-Level Evidence from a Loan Guarantee Program, *SSRN Electronic Journal* (2019). [DOI: 10.2139/ssrn.3409349](https://doi.org/10.2139/ssrn.3409349)

Provided by Bocconi University

Citation: The dark side of loan guarantee programs for SMEs (2024, June 25) retrieved 17 July 2024 from <https://phys.org/news/2024-06-dark-side-loan-smes.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.