



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem



Eliminating the Tax Shield through Allowance for Corporate Equity: Cross-border Credit Supply Effects

Swarnava (Sonny) Biswas, Balint L. Horvath and Wei Zhai

**Discussion by Peter McQuade (Central Bank of Ireland)
EBA November 2018.**

With thanks to Lorenz Emter for discussions and assistance.

Disclaimer

The opinions expressed in this paper are purely those of the authors and do not necessarily represent the views of the Central Bank of Ireland or the ESCB.



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Outline

- Description of paper
- How important is syndicated lending by Belgian banks?
- Is this an ideal laboratory for examining this policy measure?
- Distance?
- Regulatory arbitrage?



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Description

Research question:

How did the introduction of an allowance for tax deductibility of a notional interest on corporate equity in Belgium in 2006 affect banks' credit supply?

Hypothesis:

- Increased capitalisation,
- Relaxed regulatory constraints
- Reduction in funding costs

 increased credit extension by Belgian banks relative to unaffected banks



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Results

■ Test hypothesis along a number of dimensions:

1. Belgian banks increased lending on the internal margin using data on cross-border syndicated loans.
 - Identification is achieved using a difference-in-difference approach
 - Compare lending in the pre-treatment ('04-'05) to the treatment period ('06-'07)
 - For borrowers that received lending from Belgian as well as non-Belgian banks.
2. Belgian banks increased credit supply at the extensive margin, providing a larger number of loans
 - Compared to other foreign banks
 - Lending to firms in the same borrower country in the same industry.
3. Borrowers obtained loans from Belgian bank-lead syndicates with 20-50 basis points lower spreads
 - Belgian banks increased their supply of cross-border credit!



How important is this?

- Cerutti, Hale and Minoiu (2015) estimated the global value of the syndicated loan market at USD 3.5 trillion in 2012.
- What was the euro value of Belgian banks syndicated lending?
- Share of overall lending by Belgian banks from the BIS?
- Is result generalisable?



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Belgium 2004-07 - Ideal laboratory?

Boom times!

The period during which the reform was implemented witnessed an aggressive expansion of overseas cross-border lending of international banks, especially by European banks (followed by the severe retrenchment).

Makes difference in difference difficult.

Are Belgian banks typical in international comparison?

Did all Belgian banks react similarly?

- Similarly profitable before reform?
- Robust to the exclusion of individual banks?
- Dexia!

Panel A: Full sample	Mean	
	Belgian	non-Belgian
Loan characteristics	(1)	(2)
Total volume	6849.859	2511.485
Loan size	763.596	920.606
Loan spread	176.711	172.070
Maturity	73.771	75.681
Secured loans	0.117	0.170
Covenants	0.026	0.088



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Distance

Assertion: Belgian banks provided increased credit supply in more distant countries.

Results:

Distance interactions are insignificant

Interaction with contiguous only marginally significant

Table 5

	(1)
Belgian * Post	0.992 (1.55)
Belgian * Post * Z score	0.168*** (3.78)
Belgian * Z score	0.027 (1.24)
Belgian * Post * Distance	-0.160 (-1.56)
Belgian * Distance	0.060 (0.49)
Post * Distance	0.028 (0.69)
Distance	-0.138***



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Regulatory Arbitrage?

Barth, Caprio and Levine (2013) – 1/3 ain't bad?

Table 5

Belgian * Post * Official Supervisory Power	-0.071 (-1.63)		
Belgian * Official Supervisory Power	0.007 (0.16)		
Belgian * Post * Capital Stringency		0.013 (0.39)	
Belgian * Capital Stringency		-0.028 (-1.24)	
Belgian * Post * Activity Restrictions			-0.162** (-2.17)
Belgian * Activity Restrictions			0.022 (0.41)

Does finding hold if bank-year FE are included?



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Conclusion

■ Very nice paper!

■ Well established empirical method

■ Highly policy relevant findings:

- Higher capitalisation incentivised through taxation can strengthen financial stability
- Without adverse consequences for credit supply
- And without higher risk taking



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem