



# Comments on Banerjee, Cole and Duflo – Default and Punishment

---

David McKenzie  
*World Bank*



# To lend or not?

---

- Model of decision of bank officer to lend
    - Benefits:
      - *Theory*: get paid amount  $C$  per unit lent
      - *Practice*: “there are no explicit incentives for making good loans, or ways to penalize officers who make conservative decisions”
      - *Corruption*: not in model...
      - *Branch level?* Any benefit to the branch as a whole of lending a lot?
- => *Need to develop better why in practice loan officers lend.*



# To lend or not?

---

- Model of decision of bank officer to lend
  - Costs:
    - *Theory*: punishment if firm defaults on loan. Punishment function of:
      - Size of loan made (concave)
      - Level of monitoring
    - *Practice*: Punishment rare, but when it occurs, can be costly.
      - *How costly?* What share of income are we talking about for a pay decrease?
      - *Internal punishment?* Getting monitored costly for others in the branch – is there any social or explicit internal monitoring or punishment?



# To lend or not?

---

- Model of decision of bank officer to lend
  - As it stands, seems that for an honest individual, little incentive to lend, and little (expected) punishment from doing so.
  - So is this the right model, or do we need to add corrupt banker to the mix?
    - They have incentives to lend
    - Knowledge that someone corrupt around you affects your own likelihood of being monitored and getting punished for legitimate decisions – so affects your desire to be corrupt.



# Empirics

---

- Great data sets (with some limitations like not being able to separate new from old loans)
- Massive number of observations, but small number of credit-related frauds
  - 2.5 million quarterly obs.
  - 898 credit frauds
  - ⇒ difference-in-differences analysis
  - ⇒ Given small number of observations with frauds, is whole sample really the appropriate control? Should matching be used along with difference-in-differences?



# Empirics

---

- Macroeconomic Impact:
  - *Relative* impact quite large – cumulative effect of 20% less credit by affected branch over two years.
  - *But* only 36 branches per year caught out of 56,446 branches
    - *So reduces mean branch level credit growth by less than 0.005%*
- ⇒ For it to have a macro impact, need to think about how underlying perceptions of likelihood of detection and punishment affect bank officer behavior. Paper can't do this at present.