

Growing Like Germany: Local Public Debt, Local Banks, Low Private Investment^{*}

Mathias Hoffmann
University of Zurich

Iryna Stewen
JGU Mainz

Michael Stiefel[†]
University of Zurich

This version: September 2019

Abstract

Low private investment contributes to Germany's persistent current account surplus. We argue that two structural factors—the local fragmentation of Germany's banking system and the role of local public banks in local public finance— interacted with fiscal austerity are driving down the country's private investment rate. Local banks dominate lending to small and medium firms in Germany and local public banks also have an explicit mandate to lend to the local public sector. Over the last decade, fiscal consolidation at the state and federal levels put pressure on the budgets of local governments which increasingly turned to local public banks for loans. With spreads on local government debt at all-time lows, local banks tried to break even by using their market power in geographically segmented lending markets to charge higher rates on their small-and-medium sized enterprise (SME) customers. Using a unique data set of more than 1m German firms over 2010-2016, we show that firms which depend on local banks face higher interest rates and have considerably lower investment if the local bank lends a lot to the local public sector. Aggregate private investment is around 1 percent of GDP lower due this crowding-out effect.

KEYWORDS: local public banks, regional banking integration, firm-level investment, crowding out, current account, global and European imbalances

JEL-CODES: E62, F21, F32, H32

^{*}We are grateful to Pia Jankowski and her colleagues at DSGV, Isabel Schnabel, and seminar participants at the KIT Karlsruhe, the DIW Berlin and the AlpMacro Workshop for discussions and comments.

[†]Mathias Hoffmann is Professor at the Department of Economics, University of Zurich. He is also affiliated with University of Zurich's Research Priority Program in Financial Market Regulation (URPP FinReg), the CESifo Munich and the Centre for Applied Macroeconomic Analysis (CAMA).

E-mail: mathias.hoffmann@uzh.ch.

Iryna Stewen is Assistant Professor at Gutenberg School of Management and Economics, Johannes Gutenberg University Mainz, Jakob-Welder-Weg 4, D-55128 Mainz, Germany. She is also an affiliate researcher at the URPP FinReg. E-mail: iryna.stewen@uni-mainz.de

Michael Stiefel is PhD student at the Zurich Graduate School of Economics, University of Zurich. He is grateful for a scholarship by the UBS Center of Economics in Society during his graduate studies. E-mail: michaelstiefel@outlook.com