Growing Like Germany: Local Public Debt, Local Banks, Low Private Investment

Hoffmann, Stewen, Stiefel

Discussion by Thomas Drechsel
(University of Maryland)

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MAIN CHANNEL – *institutional background* – [constraints]

- Fiscal austerity at federal & state level

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$\Rightarrow$ Firms invest less [credit constraints]

STRATEGY AND FINDINGS

- Resort to detailed matched firm-bank data from Germany
- Guided by formal theory, regress at the firm-level
  - *investment*
    on
  - *exposure to public bank spread* $+$ *controls & FE*
    where
  - *public bank spread* is constructed to capture private lending rate variation that results from having to engage in public lending
- Main finding: public bank spread $1s.d. \uparrow \Rightarrow$ inv. rate median firm $0.6p.p. \downarrow$
- Much more: placebo test (Volksbanken), use state-level fiscal variation, ...

SOME PRAISE AND SOME SUGGESTIONS

- Excellent paper: important question, novel channel & tight identification
- My comments
  1. Clarify (implicit) constraints
  2. Thoughts on identification strategy
  3. Aggregate implications
  4. Smaller things

CLARIFY (IMPLICIT) CONSTRAINTS

- In terms of exposition, the paper could benefit from being more explicit about
  1. Where constraints are required to be binding for main channel to operate
  2. How plausible it is that they are indeed binding in practice
- Local government:
  - Argument about exemption from debt break is compelling $\rightarrow$ make stronger
- Local bank:
  - Equity constraint is made explicit in formal model
  - Is there any direct evidence? How does liability side of Sparkassen work?
- Firms:
  - Local firm-bank relationships $\Rightarrow$ hard to switch to Deutsche Bank
  - But why can they not switch to Volksbanken within existing set of relationship?

THOUGHTS ON IDENTIFICATION STRATEGY

- A lot of clarification is provided on exogeneity of $\mathcal{SPK}$ measure
  - Constructed with bank & municipal info $\Rightarrow$ uncorrelated with omitted time-varying firm characteristics
- However, construction of $\mathcal{SPK}$ itself relies on identifying assumptions
  - Theory justifies $\theta_t = i_t^{F,b} - i_t^{U,b} = \theta_t^b(\lambda_t^b)$, where λ_t^b is bank's public lending share
  - Retrieve $\hat{\theta}_t^b$ from nonlinear regression of $i_t^{F,b}$ on λ_t^b (and controls)
  - $\hat{\theta}_t^b$ then enters calculation of $\mathcal{SPK}$
- Suppose I have not seen your theory:
  - Would I have concerns about regressing $i_t^{F,b}$ on λ_t^b?

THOUGHTS ON IDENTIFICATION STRATEGY

- Suppose the clients of a given bank become riskier
- Therefore bank charges clients higher interest rate
- To balance risk in the loan portfolio, bank offers loans to local government
  - Remember that these are very safe
- This mechanism would also generate a positive relation between $i_t^{F,b}$ and λ_t^b but the causality would run the other way
- Similar to channel suggested in the paper, this alternative mechanism would also be weaker for Volksbanken because of these have looser ties to governments

THOUGHTS ON IDENTIFICATION STRATEGY

- I would recommend acknowledging this concern in the paper
- Importantly, I think it can actually be addressed with the IV based on state-level fiscal pressure, which is already used in a separate section of the paper
- Perhaps this IV strategy should be a more central part of the analysis
  - Currently it is more of an extension
- Need to think about exclusion restriction a bit more:
  - In my alternative story: if riskier firms also have an impact on state-level fiscal pressures, that would be an issue

AGGREGATE EFFECTS

- The paper offers some back-of-the-envelope calculations to speak about the resulting aggregate effects
  - I think this is important to underline the paper's scope
- Note that aggregation of estimates cannot account for
  - Spillover effects between firms
  - Complementary between public and private investment
- Both of these would likely make the general equilibrium effects larger
  $\Rightarrow$ aggregate effects of fiscal stimulus in Germany could be HUGE
- Pointing this out could strengthen the punchline of the paper

SMALLER STUFF

- It was not clear to me whether standard errors account for generated regressor ($\mathcal{SPK}$) in Equation (8)
- Could you provide a longer time series Figure 2?
  - Would be outside the analysis sample but still interesting
- Any anecdotal evidence of main channel
  - e.g. from talking to *Sparkassen* managers/loan officers?
- I would merge Sections 2 and 4 into one “Background” section
- Notational comment: $i_t^{F,b}$ looks like it varies by firm in first instance
- Run results only for East Germany?

SUMMING UP

- Fiscal austerity may result in low private investment because local government financing needs crowd out credit to firms
- I learned a lot from this paper and I hope my comments are helpful