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Political lendings of German savings banks

A recent paper of the Halle Institute for Economic Research (IWH) suggests that German local politicians take advantage of their influence on the credit decisions of German savings banks. “German savings banks on average increase the supply of commercial loans by €7.6 million in the year of a local election”, says IWH president Reint E. Gropp. Loans that the savings banks generate during election years also perform worse and lead to lower interest income. The results suggest that local politicians take advantage of savings banks to further their chances of re-election.

Local credit supply and prominent role of local politicians

German savings banks were established with the mandate to provide small and medium sized businesses with financing, in order to support local business and employment. Savings banks are limited by law to lend only in their local market, generally a city (“Stadtsparkasse”) or a county (“Kreissparkasse”). Local politicians occupy prominent positions within the board of directors (“Sparkassenverwaltungsrat”) and also the central credit committee (“Kreditausschuss”) in their local savings bank. The chairman of both bodies is in most cases the mayor or the county commissioner (Landrat). The positions entail significant influence on lending decisions. This enables the local politicians to follow their political motives via distorting banks’ lending policies.

Political Lending Cycles

Political business cycle theories describe politicians’ incentives towards expansionary fiscal policies prior to the elections in order to increase their own popularity via better perceived economic conditions. The empirical results of the IWH study show that this behaviour also exists in German counties, where the local politicians use the savings banks’ resources in order to engage in expansionary policies prior to the elections, by granting more loans and loans at more favourable terms. In the year when elections in their community take place, the average savings bank generates €7.6 million more commercial loans in comparison to a non-election year. For all savings banks combined this amounts to €3.4 billion Euro.

Lower Credit Quality

Loans granted based on favoritism frequently end up being of lower quality than loans which are generated in a competitive market. IWH researchers find that banks’ loss provisions are significantly higher in the years following an election while interest income is lower.

“The governance structure of German savings banks may hence induce political lending cycles, a misallocation of capital and also result in distortions of the electoral process”, says Reint Gropp. A possible solution could be to fill prominent positions within the board of directors and the central credit committee with independent outside experts.

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