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THE DETERMINANTS OF BANK INTEREST MARGINS: A POLITICAL ECONOMY VIEW

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Abstract

The purpose of this paper is to examine whether countries in which government's role is large and corruption widespread have higher bank interest margins. The importance of institutions has already been taken into account when analyzing the determinants of bank interest margins; widespread corruption and a weak legal system increase the cost of financial intermediation because of uncertainties they create. However, attention has not been given to the relationship between government and banks from the political economy view in terms of rent-seeking and interest groups. Government's role tends to be far from benevolent social planning and its policy results can be influenced by interest groups. In addition, economic history research has shown that banks have always enjoyed close relationships with political power. We examine the determinants of bank margins on the sample of Central and Eastern Europe transition economies, as well as "old" EU countries. Time period of the sample is from 1996 to 2008, and panel analysis with interaction terms is applied. Preliminary results show that an additional increase in corruption yields a higher increase in bank margins at larger levels of state interventionism.

Keywords: bank interest margin, banks, government, institutions, interest groups

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