Government Borrowing and Crowding Out

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We investigate the impact of fiscal expansions on firm investment by exploiting firms with multiple banking relationships. Further, we conduct a localized approach and compare the lending behavior of banks that barely met and missed the criteria of being a primary dealer, as well as barely winners and losers at government auctions. Our results indicate that a 1 percentage point increase in primary dealer banks' bonds-to-assets ratio decreases loans by 0.2 percent, which leads to declines in firm investment, profits, and wages. Our findings are grounded in a quantitative model with which we compute the cost of borrowing on the economy.