Local Bank Office Ownership, Deposit Control, Market Structure, and Economic Growth.

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Abstract

The restructuring of commercial banking has heightened interest in its economic consequences both for the economy as a whole and for those most likely to bear adverse consequences: small businesses, small banks, and rural areas. Most previous research on bank restructuring focuses on changes in bank behavior. In contrast, this paper focuses on the empirical association between local economic performance and changes in local bank market regulation and structure. Findings suggest that mergers or acquisitions of local banks by nonlocal banks need not impair local economic growth, and may even have beneficial effects in rural markets, with the possible exception of farm-dependent areas. These findings are derived from empirical models that relate both shortrun and longrun growth in real per capita personal income to geographic restrictions on bank activity, local bank (deposit) market concentration, local or nonlocal ownership of local bank offices, and local or nonlocal control of local bank deposits.

Keywords: Commercial banking, economic growth, geographic liberalization, bank ownership.

Acknowledgments

The authors thank Thomas Carlin, Patrick Sullivan, Jerome Stam, James Monke, James Mikesell, Daniel Milkove, Economic Research Service, USDA, Eldon Smith, University of Kentucky, and R. Alton Gilbert, Federal Reserve Bank of St. Louis, for their valuable comments and suggestions.

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May 2000

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Summary

Over the last quarter century, the number of chartered banks in the United States has declined by more than one-third. At the same time, the eight largest banks have increased their control of total U.S. bank assets: from 22 percent in 1988 to 36 percent in 1997. This restructuring of U.S. commercial banking has heightened interest in its economic consequences, especially for those businesses and areas most likely to bear adverse consequences: small businesses, small banks, and rural areas. Our analysis suggests that mergers or acquisitions of local banks by nonlocal banks need not impair local economic growth and may even have beneficial effects in rural markets, with the possible exception of farm-dependent areas.

This analysis adds to the growing literature on geographic liberalization of bank regulations, bank ownership structure, and local market concentration. The focus is on the association between economic growth and the structure and location of bank ownership in local markets. Both international and domestic studies have found important positive linkages between financial markets and growth. The research presented here extends this line of inquiry by relating bank market structure and regulatory change to economic growth at the local market level. A central issue is the distribution of previously documented positive relationship between geographic deregulation and State-level growth among metropolitan and nonmetropolitan areas. Other important issues revolve around the impact of bank market concentration, out-of-market (nonlocal) ownership of local bank offices, and out-of-market control of local deposits.

Results generally support the importance of the linkage between geographic liberalization and local growth in the short run. Estimates of this impact in metropolitan markets range as high as 1.2 percent per year or 87 percent of expected growth rates. Nonmetropolitan markets exhibit a smaller but still important impact of 0.84 percent per year or 53 percent of expected growth rates. These results are qualitatively robust to different model specifications. Market concentration and bank ownership structure do not explain the impact of liberalization on local shortrun growth. In addition, statistical tests indicate that local bank market structure has a statistically significant association with local economic growth. However, the location of neither bank office ownership nor deposit control is statistically related to shortrun growth in nonmetropolitan areas. In metropolitan areas, out-of-market ownership of bank offices is associated with lower shortrun growth rates, though the magnitude of this effect is economically small. Results from our longrun model generally support and enrich our shortrun results.

Farm-dependent markets appear to fare less well following geographic liberalization. In these markets, liberalization is associated with a decrease in shortrun growth, and higher initial levels of out-of-market bank ownership are associated with a fall in longrun growth in the 1984 to 1996 period. However, the shortrun result is not robust, and local cycles in the farm economy rather than changes in banking may explain it.

These results are derived from empirical models that relate both shortrun and longrun growth in real per capita personal income to geographic restrictions on bank activity, local bank (deposit) market concentration, in-market or out-of-market ownership of local bank offices, and in-market or out-of-market control of local bank deposits. We estimate separate models for metropolitan, nonmetropolitan, and farm-dependent markets. The latter markets are a subset of nonmetropolitan markets and are of interest because of the historic link between these markets and restrictions on bank branching. We estimate longrun models over two time periods. The first—from 1973-84—largely predates liberalization in nonmetropolitan areas, while the second—from 1984-96—coincides with increasing liberalization of geographic banking restrictions.