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

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Introduction

Over the last quarter century, commercial banking in the United States has undergone a profound and continuing restructuring. The number of banks has fallen dramatically while the size and complexity of many banking organizations have increased in an equally dramatic fashion (Berger *et al.*, 1995). For example, the number of chartered banks in the United States fell from roughly 14,000 in 1973 to 9,500 in 1996, while the total number of bank offices rose from about 40,000 to 67,000 in the same period. Banking assets have also become more concentrated among bank firms. From 1988-97, the largest eight banking firms increased their share of total bank assets from 22 percent to 36 percent. Banks with less than $100 million in assets (1994 implicit GDP deflator dollars) held 14 percent of bank assets in 1979 but only 7 percent by 1994. During the same period, banks with over $100 billion grew from 10 to 20 percent of total bank assets. These trends have accelerated in the past few years as interstate banking has been phased in. As of yearend 1998, the number of chartered commercial banks had fallen to 8,774 while the number of total bank offices had increased to 70,731.

This restructuring is the result of technological advances, competitive forces, and regulatory and statutory changes. One of the more pervasive regulatory changes has been the wholesale abandonment of geographic restrictions on banking activity. In 1960, 39 States had some kind of limit on intrastate branching, including 19 States that prohibited branching altogether. In addition, 22 States limited the activities of multibank holding companies, which serve as a functional alternative to branching banks. Of these 22 States, 15 prohibited multibank holding companies altogether. Common geographic restrictions limited the number of bank offices (unit banking States) or the geographic scope of any branching (often to the home county). In 1973, over 60 percent of banks (9,200 of 13,964) were unit banks. This proportion decreased to roughly 50 percent by 1984 (7,426 of 14,483) and to 33 percent (3,279 of 9,510) by 1996. In terms of total banking offices, the change is more dramatic. Unit banks represented about 25 percent of all banking offices in 1973, about 15 percent in 1984, and about 5 percent by 1996.

The restructuring of U.S. commercial banking has heightened interest in its economic consequences both for the economy as a whole and for those businesses and areas most likely to bear adverse consequences: small businesses, small banks, and rural areas (see, for example, USDA, 1997; Federal Reserve Bank of Kansas City, 1997). The ongoing consolidation of European banking has raised similar concerns. This report focuses on the rural impact of bank restructuring. Rural areas, especially those traditionally served by unit banks, have a long history of fear, suspicion, and antipathy toward bank consolidation and nonlocal control. Many rural residents and

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business people expect the current restructuring to harm their communities despite fairly compelling theoretical and empirical evidence that at least some degree of liberalization provides considerable overall economic benefits. These fears arise in part from northern European agrarian traditions that emphasized the need to limit banking firms. Regardless of the economic merits of these beliefs, they undergird support for restrictions on banking activities and remain politically important.[1]

This report adds to the growing literature on geographic liberalization of bank regulations, bank ownership structure, and local market concentration. The focus of this literature is on the association between various measures of economic growth and the structure and location of bank ownership in local markets. This report represents a first attempt to examine empirically the association between economic growth, as measured by real per capita income growth rates, and out-of-market bank ownership and local bank market concentration across local banking markets (defined as metropolitan statistical areas or nonmetropolitan, rural counties).[2] In examining these linkages, we control for the nature of the local economy, *ex ante* bank ownership structure and market concentration, and coevolution of bank structure and market concentration. We investigate possible omitted variables and reverse causality as well.

The report proceeds as follows. The next section discusses some of the reasons why locally owned banks may behave differently from nonlocally owned banks, especially in economically small areas. The following section reviews the literature on the most controversial aspects of liberalizing geographic restrictions on commercial banking and the impact on rural areas. It also reviews the results of the relatively new literature relating financial factors to general economic performance. Subsequent sections present our empirical model, data considerations, and results. Finally, we discuss the conclusions from this work and avenues for fruitful further research.

[1]For example, Texas and Montana opted out of interstate branching and Colorado considered doing so as authorized in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. However, the Office of the Comptroller of the Currency (OCC, regulator of national banks) ruled that opting out does not prevent nationally chartered (as opposed to State-chartered) banks from branching across State lines. This ruling caused the Texas Commissioner of Banking to nullify rules prohibiting interstate branching since they put State-chartered banks at a competitive disadvantage.

[2]Employment growth is a prominent alternative measure of economic growth that occurs in the development literature. For expositional tractability, we focus this report on income growth, deferring an investigation of the relationship between employment growth and bank market structure for subsequent research.