



Geographical segmentation of US capital markets[☆]

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Abstract

Demographic variation in savings behavior can be exploited to provide evidence on segmentation in US bank loan markets. Cities with a large fraction of seniors have higher volumes of bank deposits. Since many banks rely heavily on deposit financing, this affects local loan supply and economic activity. I show a positive effect of local deposit supply on local outcomes, including the number of firms, the number of manufacturing firms, and the number of new firms started. The effect is stronger in industries that are heavily dependent on external finance. The deregulation of intrastate branching reduced the effect of local deposit supply by approximately a third.

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1. Introduction

In most economies, banks play a large role in the intermediation of capital from suppliers to users. Unlike financial markets, banks are principally local intermediaries. This applies to both sides of the balance sheet. On the liability side, banks rely heavily on deposits for funding (Kashyap and Stein, 2000) and most deposits are local. On the asset

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side, much bank lending is local (Petersen and Rajan, 2002). For these reasons, local variation in the supply of deposits could translate to local variation in the availability and cost of capital for borrowers and, hence, in the level of economic activity.

Geographical segmentation is difficult to identify empirically, however. A direct approach is to examine the correlation between local lending volumes and local economic outcomes. In practice, this approach suffers from a severe endogeneity problem because the volume of local bank lending is likely to respond to both supply and demand for loans. The demand for loans is trivially correlated with economic outcomes. So, to evaluate whether the local supply of capital affects local economic outcomes, a source of exogenous variation in the supply of bank loans is necessary. This paper utilizes demographic variation in the supply of deposits as such a determinant of local capital supply. Seniors (those age 65 and older) tend to hold higher levels of bank deposits than other groups both in absolute terms and as a fraction of portfolios. However, because seniors do not participate much in the labor market or operate businesses, and because they consume less than other groups, the impact of a large fraction of seniors on the local demand for business finance is likely to be small and perhaps negative (See Section 2 for a more detailed discussion of the effect of seniors on loan demand.). Hence, a large fraction of seniors in an area causes a higher supply of intermediated finance relative to local demand for external financing. This makes the fraction of seniors a potentially useful instrument for the local supply of finance (relative to demand).

Substantial demographic variation exists within the US, both across and within states. I use data on the fraction of seniors at the level of metropolitan statistical areas (MSAs) to predict deposit volumes and loan availability. This level of geographical detail permits including state fixed effects in regressions. Exploiting only within-state variation, I show that a high fraction of seniors corresponds to a high supply of deposits. In areas with high deposit supply, local banks use relatively more deposit financing (as opposed to equity and nondeposit debt) and have more liquid balance sheets (as measured by holdings of treasury securities).¹

Using seniors as an instrument for deposit supply, I show that this supply is related to local economic outcomes. MSAs with high levels of deposits have more firms, more manufacturing firms and establishments, relatively more small firms (up to 19 employees) and fewer large firms (more than five hundred employees), and more new firm starts. Using a measure of dependence on external finance, based on Rajan and Zingales (1998), I show that the effect of the local deposit supply is stronger in industries that are more externally dependent (i.e., those industries in which, on average, Compustat firms use more external financing).

I next examine the robustness of these results to several possible concerns. To address the potential endogeneity of seniors, demographic predictions are used in the place of actual data on seniors (middle-age people 20–30 years in advance), and the results remain similar and significant. I also consider the possibility that the seniors variable is correlated with wealth, perhaps driving economic outcomes through an effect on demand. I attempt to control for wealth by including average local house prices and per capita income as

¹MSAs are defined by the Office of Management and Budget as a federal statistical standard. An area qualifies for recognition as an MSA if it includes a city of at least 50 thousand inhabitants or an urbanized area of at least 50 thousand with a total metropolitan area population of at least 100,000. MSAs typically incorporate several counties and sometimes straddle state borders.

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