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Local bank office ownership, deposit control, market structure, and economic growth

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Abstract

This paper tests empirical associations between banking market structure, banking regulation, and subsequent growth rates in local real per capita personal income. Our findings suggest that out-of-market bank mergers or acquisitions need not, ceteris paribus, impair local economic growth, and may even have beneficial effects in rural markets with the possible exception of farm-dependent areas. These findings derive from empirical models that relate both short-run and long-run growth rates to geographic restrictions on bank activity, concentration in local banking markets, in-market versus out-of-market ownership of local bank offices, and in-market versus out-of-market control of local bank deposits.

JEL classification: G21; O4; R51
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1. 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 has increased

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(Berger et al., 1995). As the number of chartered banks in the U.S. fell from roughly 14,000 in 1973 to 8774 in 1998, the total number of bank offices rose from about 40,000 to 70,731 in the same period. The largest eight banking firms increased their share of total bank assets from 22% in 1988 to 36% in 1997. Banks with less than $100 million in assets (1994 implicit GDP deflator dollars) held 14% of bank assets in 1979 but only 7% by 1994. During the same period, banks with over $100 billion grew from 10% to 20% of total bank assets. These trends have accelerated in the past few years as interstate banking has phased in.

This restructuring has been fostered by technological advances, competitive forces, and regulatory and statutory changes. One major regulatory change has been the wholesale relaxation of geographic restrictions on banking activity. In 1960, 39 states imposed some limit on intrastate branching, with 19 states prohibiting 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. Some states 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% of banks (9200 of 13,964) were unit banks. This proportion decreased to roughly 50% by 1984 (7426 of 14,483) and to 33% (3279 of 9510) by 1996. In terms of total banking offices, the change is more dramatic. Unit banks represented about one quarter of all banking offices in 1973, about 15% in 1984, and about 5% by 1996.

The restructuring of U.S. commercial banking has raised questions concerning its economic consequences, both for the economy as a whole and for those businesses and areas most likely to bear adverse consequences disproportionately: 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 in that context as well. This paper focuses on the association between various measures of economic growth and the structure and location of bank ownership in local markets. The study represents a first empirical look at the impact of out-of-market bank ownership and local bank market concentration on per capita income growth rates. 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 results suggest that out-of-market bank mergers or acquisitions need not, ceteris paribus, impair local economic growth, and may even have beneficial effects in rural markets with the possible exception of farm-dependent areas.

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 business people expect the current restructuring to harm their communities despite fairly compelling evidence that 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 popular