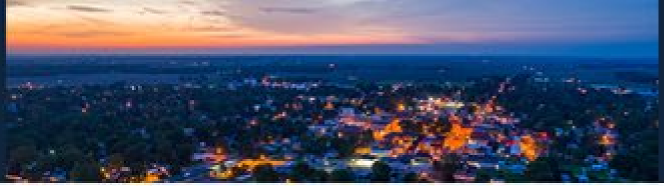

Big Banks, Household Credit Access, and Intergenerational Economic Mobility

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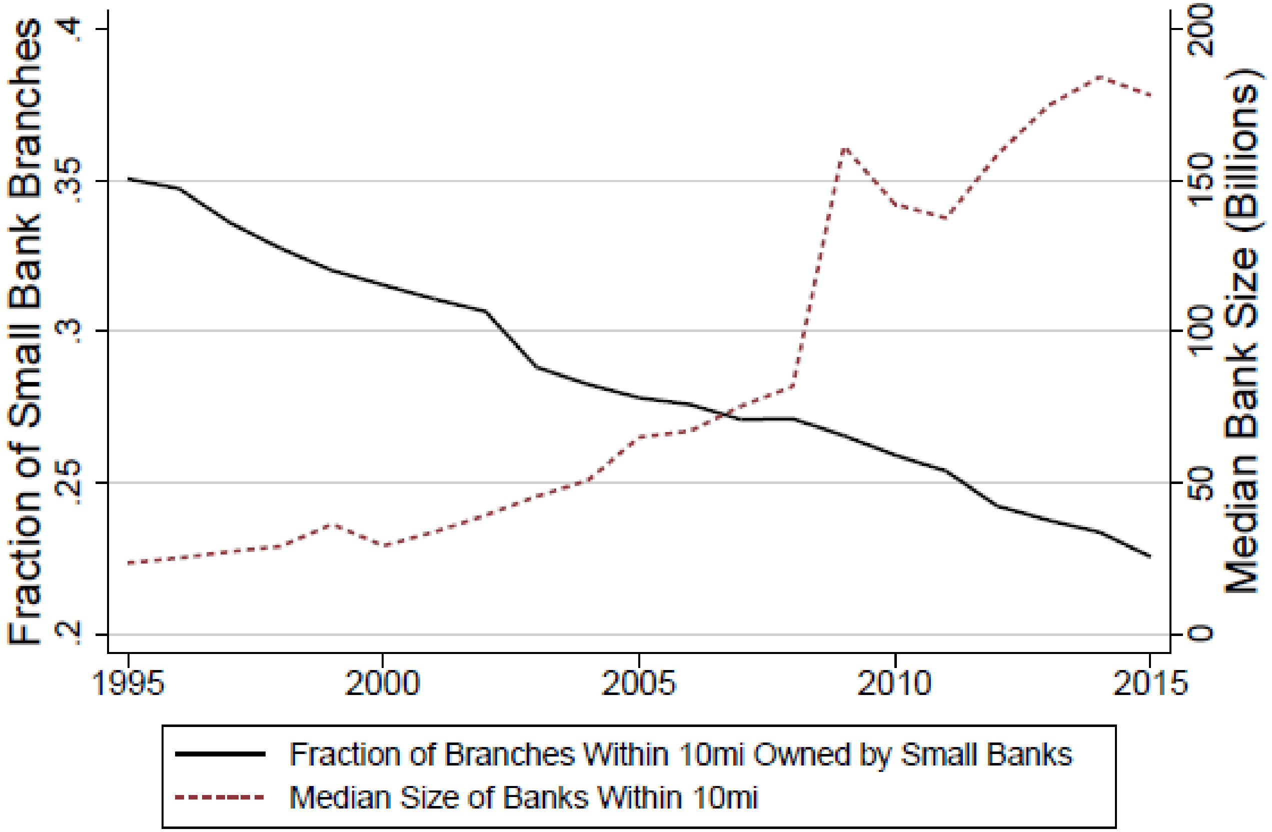
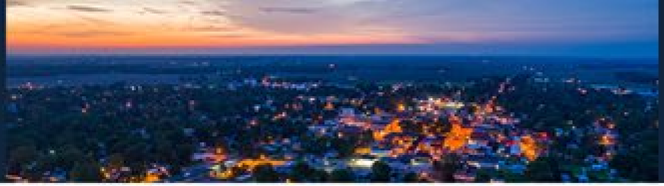
Central Questions:

1) How does the composition of local banking markets (big banks vs. community banks) affect low income households' access to credit?

2) Does the composition of local banks have long-run effects on economic inequality?

Consolidation has led to much larger banks.





Should large banks lead to more or less credit access for households?

<u>"Large Banks → More Credit" Argument:</u>

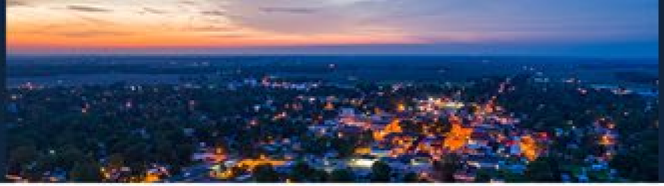
- Large banks benefit from economies of scale and diversification, and lend out a higher proportion of capital (e.g., Diamond (1984) and Demsetz and Strahan (1997))

<u>"Large Banks → Less Credit" Argument:</u>

- Banks with hierarchical structure (large banks) have a comparative disadvantage lending on "soft" information
  - Stein (2002) – research incentives, Brickley et al. (2003) – ownership incentives
  - Berger et al. (2005) and others show this empirically for small business lending

<u>Asymmetry to Notice:</u>

- The "Large Banks → Less Credit" argument applies primarily to borrowers who rely on soft information collection for credit access



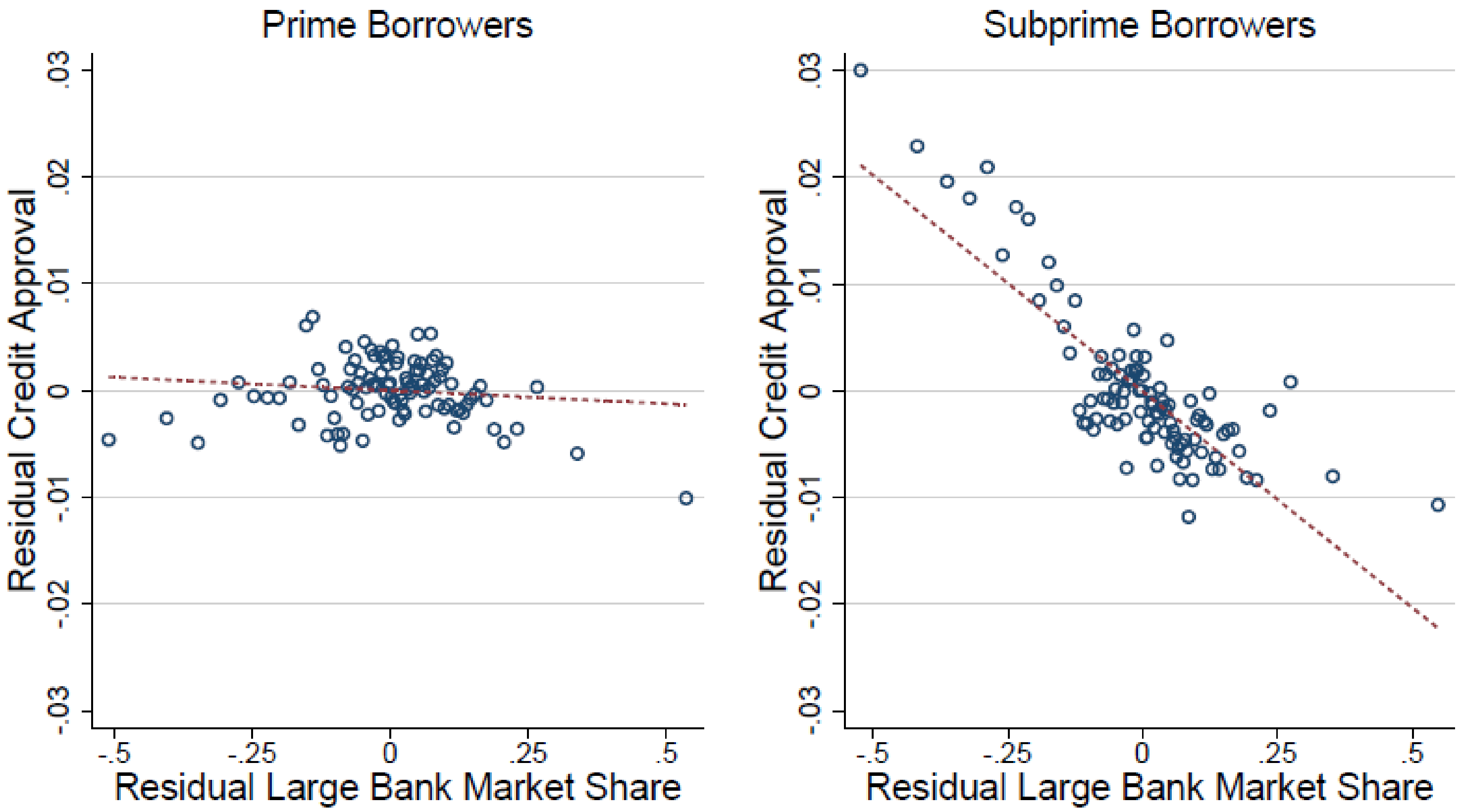
Three Key Findings:

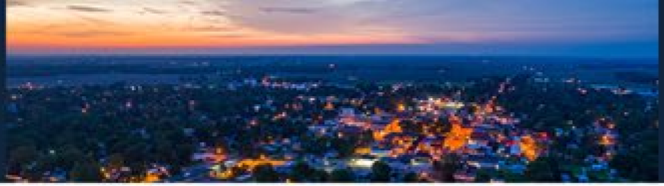
1) Low income households have better access to credit when local banks are smaller.
   - Analysis based on credit bureau data.

2) Community banks' additional lending to low income households stems from an advantage at utilizing soft information.
   - Analysis based on mortgage applications from HMDA.

3) Improved credit access for low income families leads to higher intergenerational economic mobility levels … i.e., children have better life outcomes.
   - Analysis based on new county-level measures of mobility from Chetty et al. (2014).

Finding 1: Community banks improve low income households' access to credit.





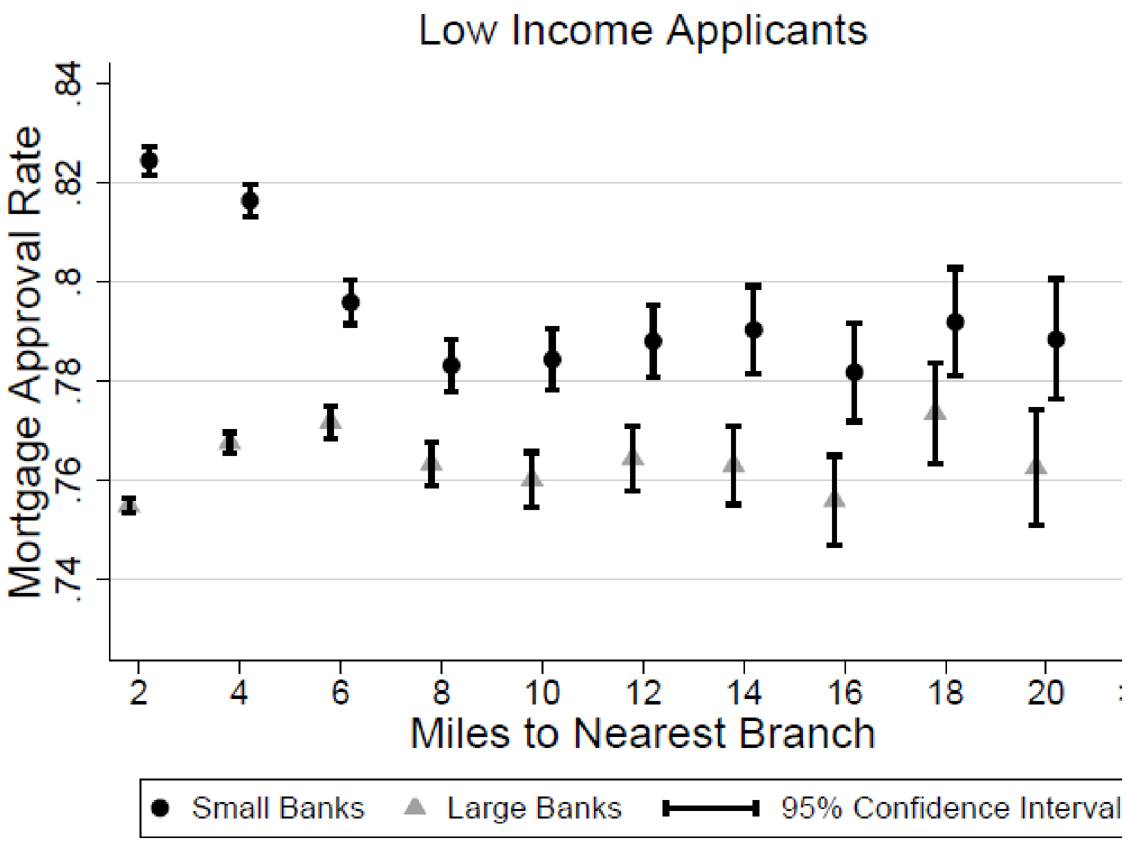
How large/robust is this effect?

- A std dev increase in local ***Large Bank Market Share*** reduces subprime borrowers' approval rates by **4 percentage points** (compared to 53% mean approval).

- These results hold in a variety of subsamples, and using either OLS, or an IV approach based on differences in regulation and state borders.

- Low income borrowers in areas with larger banks are more likely to borrow using expensive sources like credit cards, and from retailers.

Finding 2: Community banks' additional lending to low income households stems from a soft information advantage.



Rigorous tests show that:

1) The effect of distance is more than twice as large at small vs. large banks

2) The effect of distance is three times larger for low income vs. high income apps

3) Despite the additional approvals, small banks' loans do not default more

These findings are consistent with small banks using more soft info, and this info being most important for low income applicants

Now, let's talk about intergenerational economic mobility.

- Mobility describes the disparity in outcomes between children from high vs. low income families (i.e., equality of opportunity)

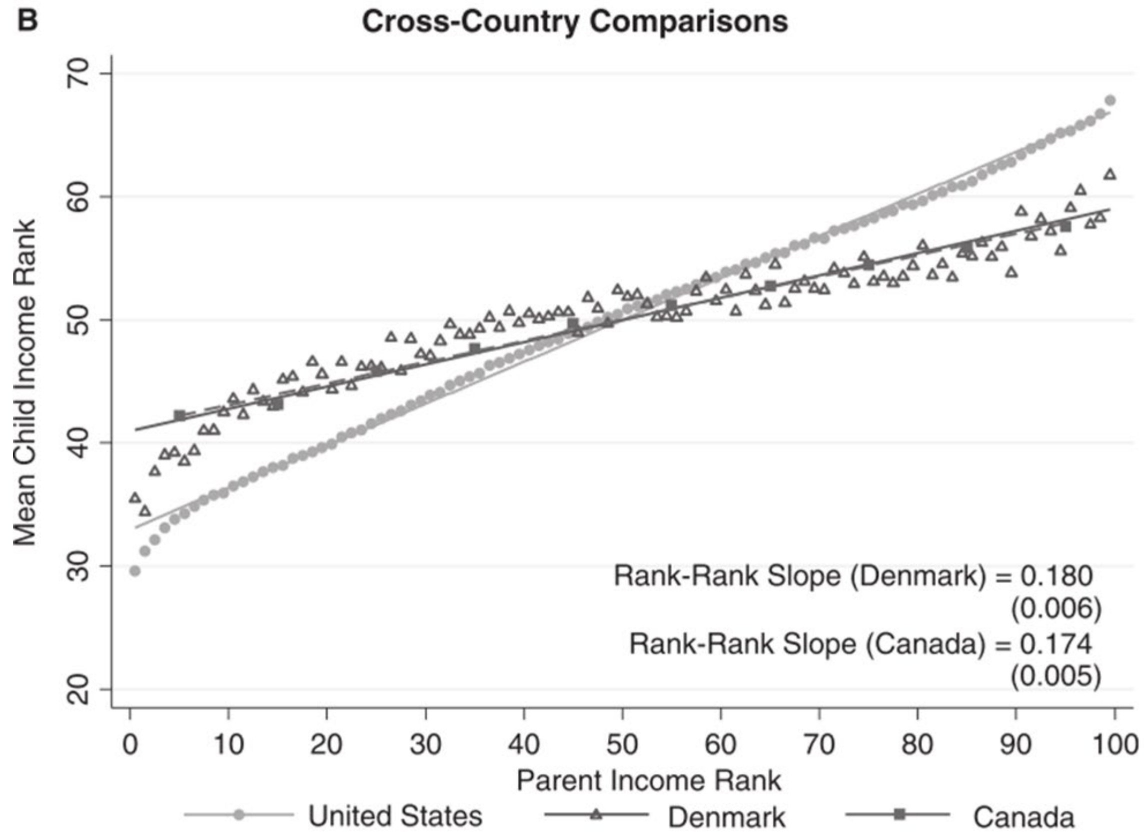
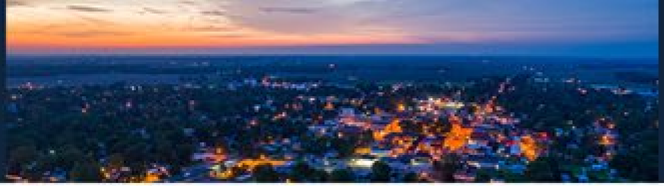


Figure from Chetty et al. (2014)



There is tremendous variation in local upward mobility levels within the U.S.

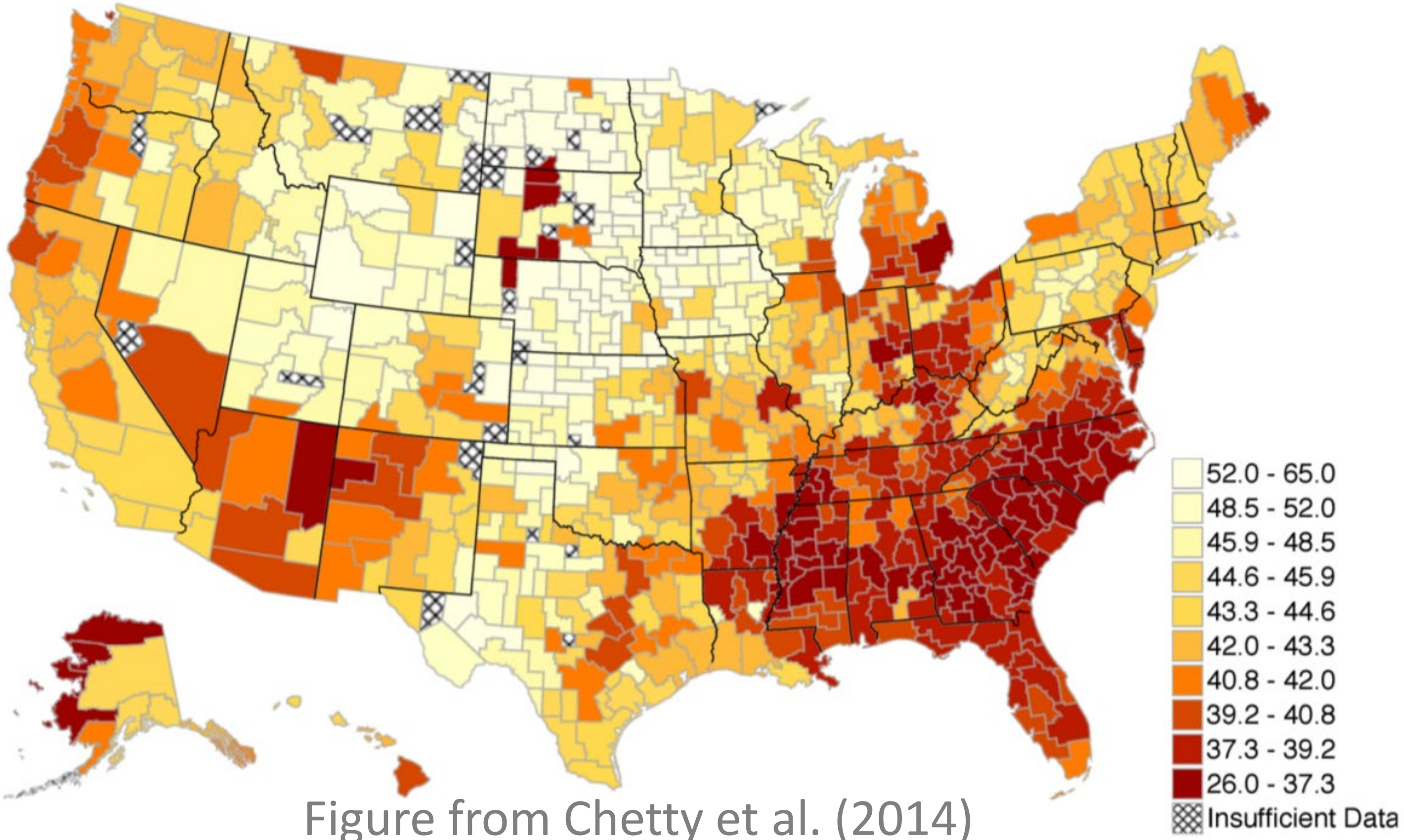


Figure from Chetty et al. (2014)

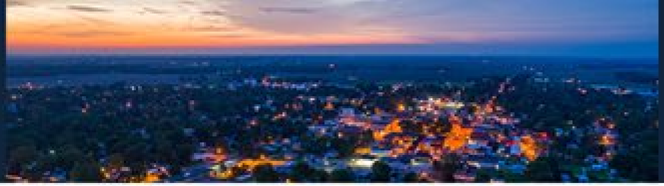
Credit access should facilitate upward mobility.

Intuition:

- Credit constraints limit low income parents' investment in their children's human capital, and therefore reduce mobility levels (e.g., Becker and Tomes 1979, 1986)
- Examples:
  - Home purchase → nice neighborhood, good school district
  - Day care, after-school activities, private school, college prep, summer internship vs. job to earn cash

Analysis:

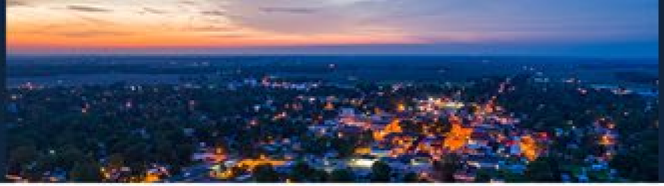
- Carefully controls for non-banking factors.
- Isolates the effect of banking using an IV approach based on historical differences in the timing of interstate deregulation.



Finding 3: By providing credit to low income families, community banks facilitate upward mobility.

Outcome Variable: Transition out of Bottom 40% of income distribution (mean= 51%, Std Dev = .11)

	IV		
	Full Sample (4)	MSA (5)	Non-MSA (6)
Large Bank Market Share	-0.0473***	-0.0781***	-0.0320***
	(0.00861)	(0.0235)	(0.00913)
Controls: Yes			
R^2	0.685	0.281	0.763
Observations	2420	857	1563



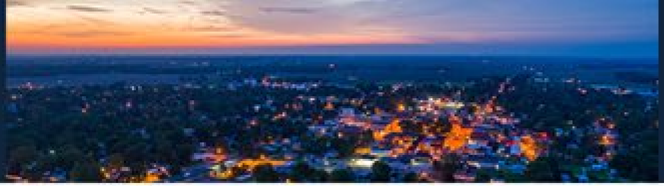
Recap

1) Community banks incorporate more soft information into their lending, which makes them important providers of credit for low income households.

2) By easing credit constraints for low income households, small banks facilitate upward mobility.

Final Thought

Financial institutions’ role in economic inequality is a promising area for future work.



Thank You!