Rise of Bank Competition: Evidence from Banking Deregulation in China

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Rise of Bank Competition: Banking Deregulation in China

This paper

Does bank competition spur economic development?

Idea:

- Exploit 2009 bank branch deregulation in China to investigate impact on economic activities

Findings:

1. Nr. of branches and lending increases
2. Most new loans go to existing borrowers and a high lending share goes to state-owned enterprises (due to soft budget constraint)
3. Screening on private borrowers improves
4. Borrowers (firms) expand investments, employment, profitability

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Contribution

- Pitch:

  Trade-off between bank competition improving capital allocation versus financial instability

- Contribution on the debate on:
  - Sequenzing of liberalization matters
  - Deregulation under existence of soft budget constraints (Identification of potential unintended consequences)
  - Impact of bank ownership on credit allocation

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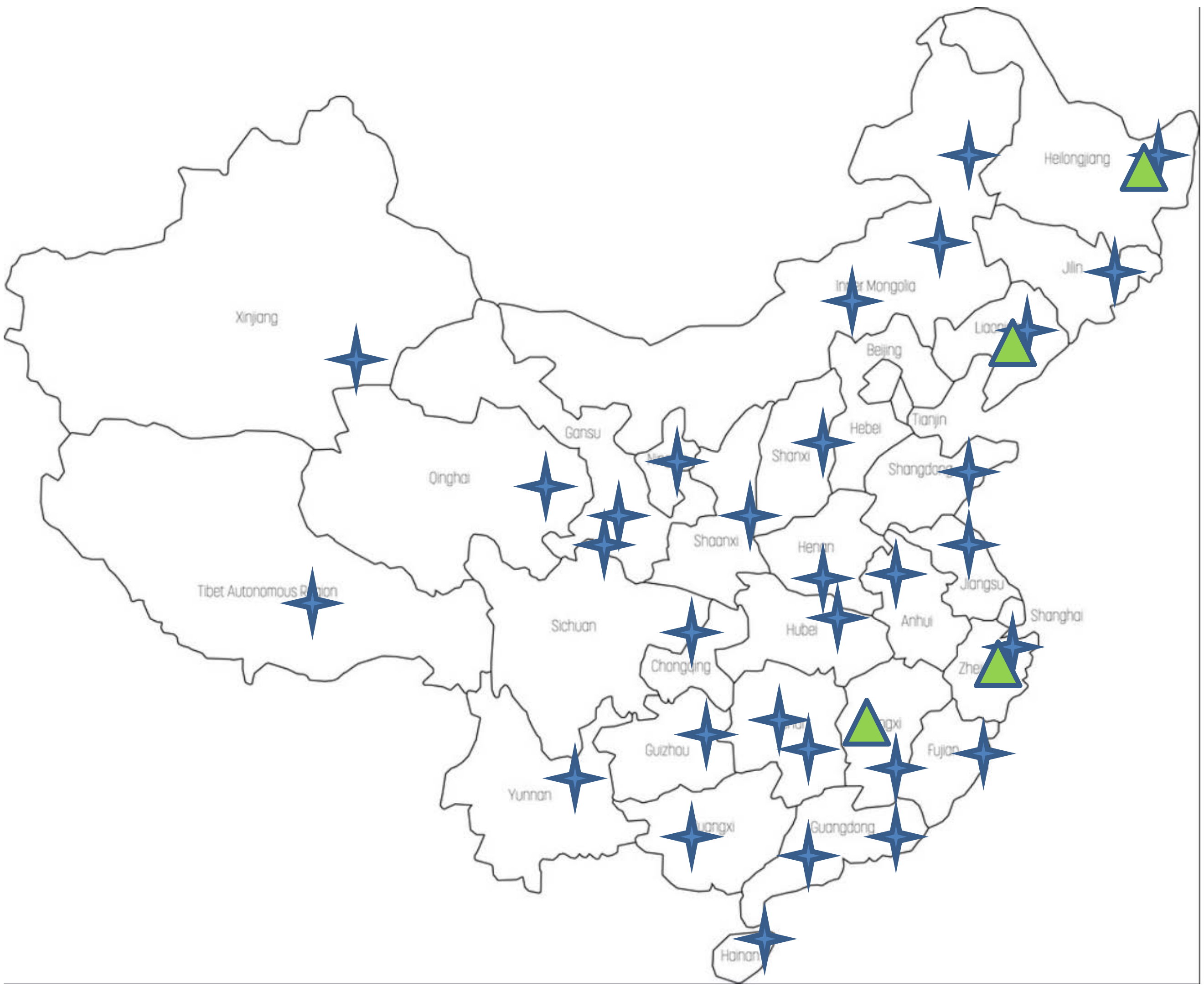
Empirical Set-up: 2009 deregulation



4 state owned banks

12 joint equity banks

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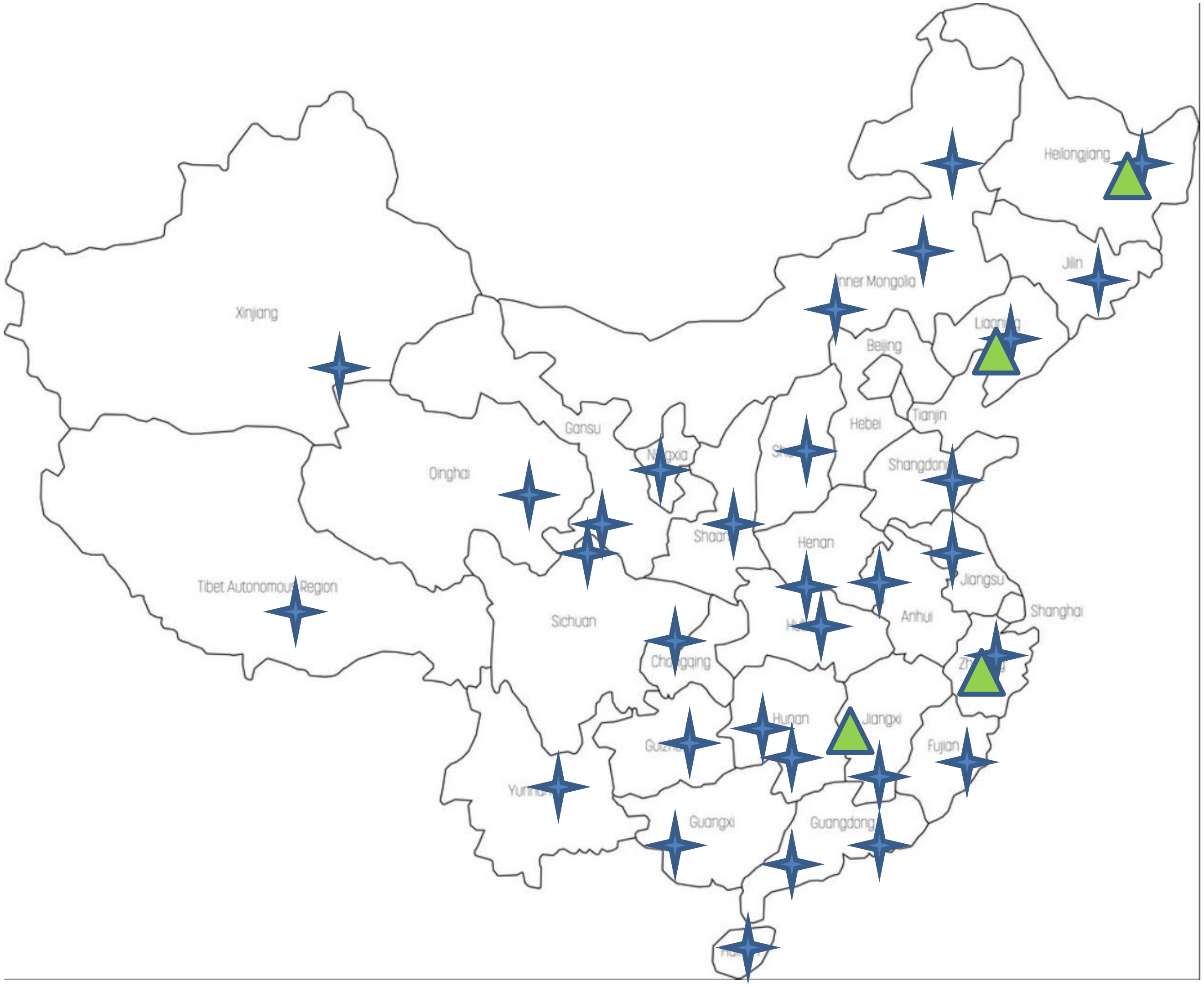
What would be an ideal experiment to measure impact of bank competition in DiD setting?



1. **Pre-intervention:** Homogenous banks get treated or not
2. **Intervention:** Randomized provinces deregulate
3. **Post intervention:** Measure agg. economic performance

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Empirical Set-up

1. **Pre-intervention:** Homogenous banks get treated or not

- Treatment and Control group banks differ systematically: 4 SOEs vs. 12 Joint Equity Banks (DID: relative interpretation)
- Reform could potentially by driven by poor performance of 4 state banks

- *Consequences:*
  - Hard to disentangle change in ownership vs. change in competition
  - Behavior of SOEs could change post-intervention endogenously

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Empirical Set-up

2. Intervention: Randomized provinces deregulate

- “Treatment of a city“ depends on whether a joint equity bank has a branch in a given city/province capital
- Pre-intervention branch location of joint banks is not random: joint equity banks have applied for (restricted) licenses
- Decision where to apply for a (restricted license) likely depends on expectations on future development

- *Consequences:*
  - Creates bias in the direction of finding more investments, efficiency, and profitability

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Empirical Set-up

3. Post intervention: measure aggregate economic performance

- Analysis on real effects focuses only on firms in a lending relationship
  - Spill overs are neglected
  - Crowding out is neglected
- It is not surprising to find more investment and profitability in a sample of firms that have a substantial lending relationship
- To evaluate real economic consequences its important to take these differences into account especially given the increase in lending share to „inefficient“ enterprises

- Same for financial stability: Are is the diversification of bank risk taking affected (Goetz, Laeven, Levine, 2016, JFE)

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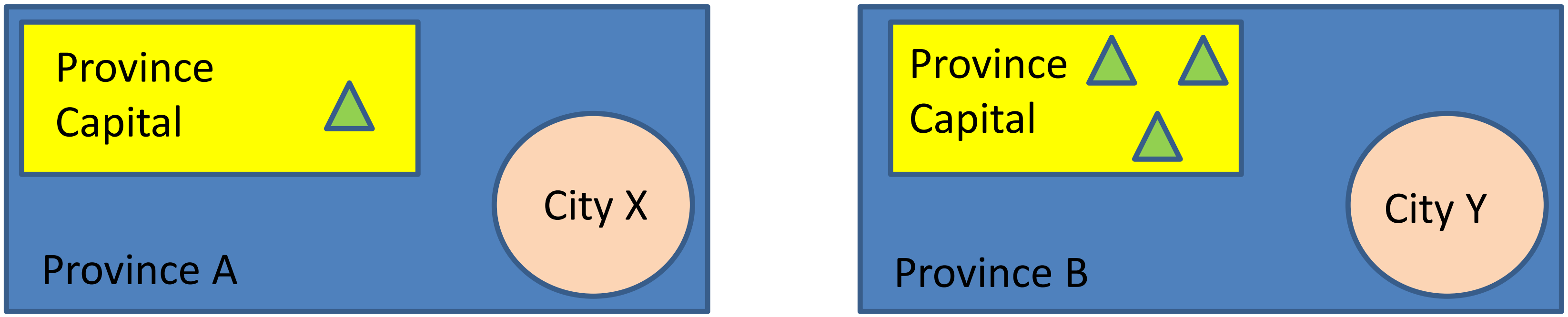
Suggestion 1: Alternative Identification



1. Focus on within joint equity variation in competition
2. Focus on non province capital cities (ideally without pre-intervention joint equity branches)
3. These cities are differentially affected due to competition (city x: only on bank can enter; city y: three banks can enter)

Advantage:

- No comparison between actions of state-owned and private banks
- No bias due to pre-intervention branch location decision (as long as economic development of non-capital and capital cities is uncorrelated)

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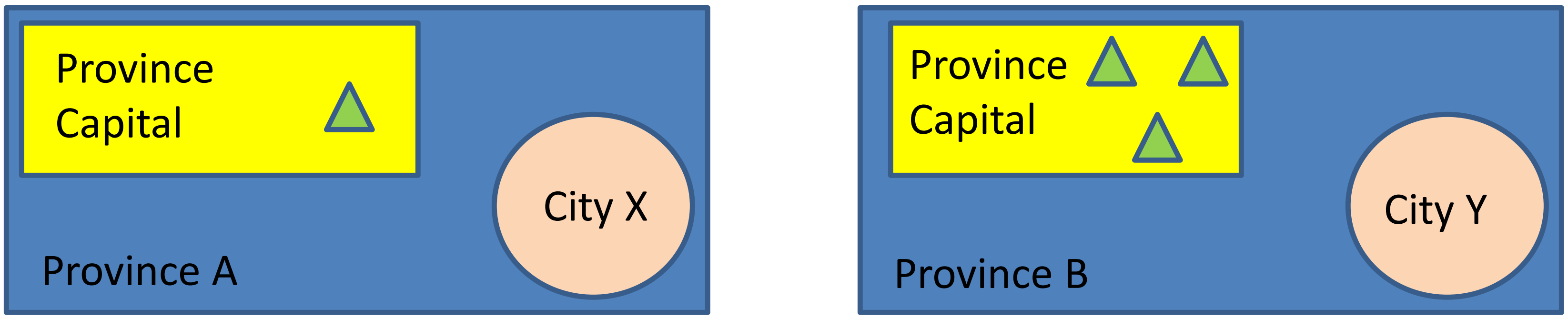
Suggestion 2: Real analysis



1. For measuring aggregate impact focus on aggregate measure of City X and City Y
   - regional GDP growth / investment
   - unemployment rate
   - Entrance and exit of firms
2. Focus on aggregate riskiness of joint stock banks
3. Compare more or less affected areas

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Conclusion

- Very interesting paper I recommend everyone to read
- Unique empirical study on impact of branch deregulation in China
- Novel insights about potential unintended consequences of deregulation if soft budget constraints are present
- Tone down language and name identification concerns /confounding factors
- Relate to US branch deregulation experience
- Maybe exploit further identification strategies as suggested