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The Decline of Local Banking in the United States

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- The share of deposits held in locally-owned banks has fallen steadily in the US and in Colorado since the 1990s.
- This shift has hit already-underserved rural Colorado counties especially hard.
- A decline in local bank shares imposes welfare costs on consumers and business ventures seeking financial services, and contributes to macroeconomic instability.

Since the Great Recession of 2007-2009, the United States' banking system has been the subject of much attention. "Too big to fail" is a term now commonly used by both the media and the public. Pundits, policymakers, and—at times—economists, have laid partial blame for the Recession on the Financial Services Modernization Act of 1999, a piece of legislation which repealed an older rule established under the Glass-Steagall Act requiring investment banks and commercial banks to operate as separate entities. What these discussions miss is a longer trend of consolidation in the U.S. banking industry, a key component of which has been the decline of local banking.

The Federal Deposit Insurance Corporation (FDIC) maintains data on the total dollar value of deposits made at every FDIC insured bank branch. Using this data, we estimate how important local banking is to a community. Figure 1 plots the movement of the average share of local bank deposits in a county that were made at institutions headquartered in that county -- the local deposit share -- from 1994 to 2016 for both the entire United States and the state of Colorado.

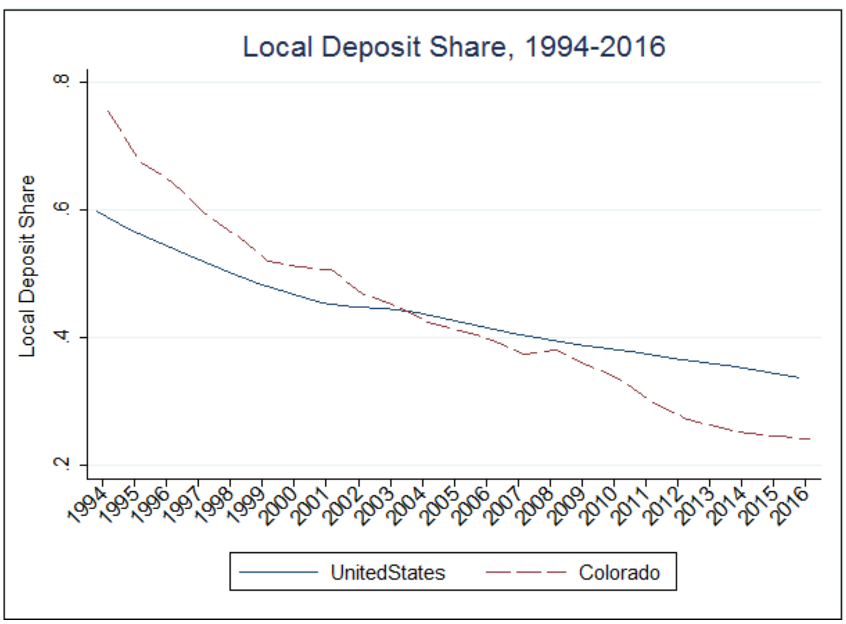

Figure 1

The figure shows a clear downward trend in the local deposit share, falling from approximately 60% to 30% for the entire United States and from near 80% to 20% for the state of Colorado. Further, the fraction of consumer deposits going to the four largest U.S. banks (JP Morgan Chase, Citibank, Bank of America, and Wells Fargo) is nearly 40% as of 2016.

In addition to the risks introduced by concentration of consumer deposits in "too big to fail" banks, the decline in local banking means that households, businesses, and entrepreneurs are also potentially losing out on services that are important for economic well-being and sustainable development. Rural areas are among those hit hardest by banking consolidation, as these areas are not always serviced by larger, national institutions. The loss of local banking thus may mean the loss of banking in general for those who reside in areas where other options are not available.

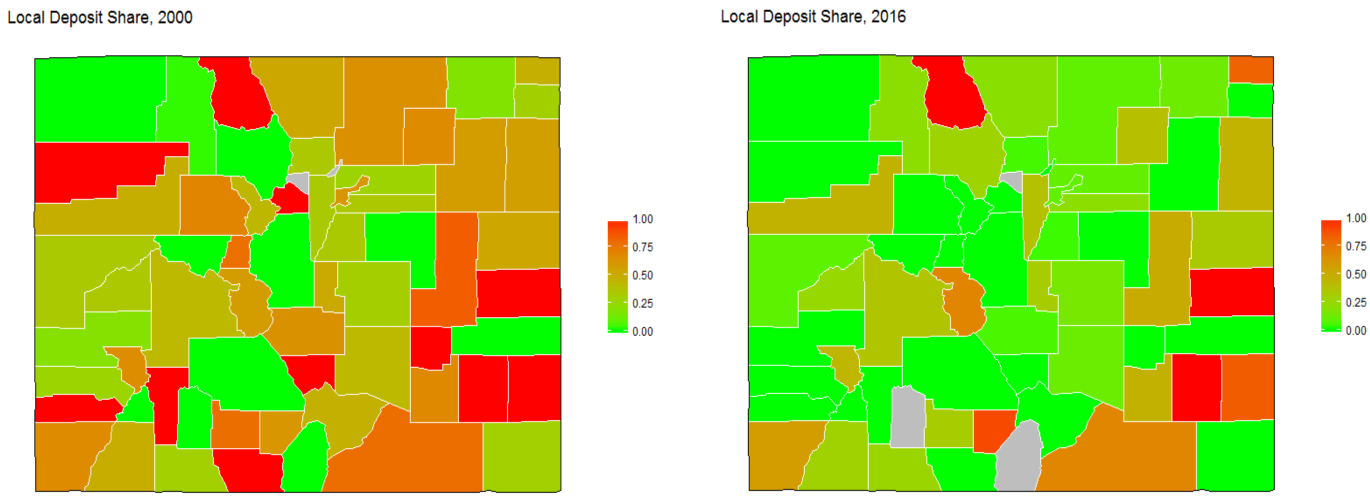

Figure 2: Map shows the share of county deposits at local banks. Dark red corresponds to a larger local deposit share.

Figure 2 illustrates the dramatic nature of the decline of local banking for the state of Colorado. Between 2000 and 2016 many counties within Colorado went from having a significant local banking presence in terms of the share of deposits made at institutions headquartered in that county to having no local banking presence at all. Costilla and Mineral counties went from having at least one bank branch, despite having no local bank branches to having to no bank branches at all[1].

These trends have important implications. If the decision-making process of local banks relies on a relationship lending channel that is otherwise absent in the decision making of larger, national institutions, then a shift in the composition of banking that favors national institutions may affect who gets access to credit. Access to credit (or lack thereof) determines who can purchase homes, start businesses, and undertake creative endeavors. Because these endeavors are central drivers of economic growth, the loss of funds that make these endeavors possible will affect the long-run trajectory of regional economies. Thus, while the rise of "too big to fail" undoubtedly played a role in the Great Recession, the shift in U.S. banking away from a model based on interaction between local institutions and local people may have consequences that are yet unrealized.

[1] As of October 2017, Del Norte Bank has since opened a branch in Creede, Colorado in Mineral County, leaving the county with one remaining bank branch.