
AROUND THE FED

Banks of All Sizes

BY DOUG CAMPBELL

“Changes in the Size Distribution of U.S. Banks: 1960 - 2005.” Hubert P. Janicki and Edward Simpson Prescott, Federal Reserve Bank of Richmond *Economic Quarterly*, Fall 2006, vol. 92, no. 4, pp. 291-316.

It's no secret that the U.S. banking industry has experienced significant consolidation over the past few decades. Amid rapid consolidation, the number of banks operating in the country since 1960 has fallen from 13,000 to about 6,500. The conventional wisdom is that there is no end in sight to this trend, with the big banks getting bigger and midsized banks all but disappearing, to create a “barbell” industry shape. In a new article, researchers at the Federal Reserve Bank of Richmond call into question elements of the conventional wisdom. Hubert Janicki and Edward S. Prescott document the decline in bank numbers and draw several new findings. Among them: The pace of new bank openings has been relatively constant over time. Entry averages about 1.5 percent of total operating banks.

The authors also document striking changes in bank growth starting in 1980, about the time when deregulation started. They find that before this point, bank growth was consistent with “Gibrat’s Law,” which states that firm growth is independent of firm size. After 1980, they find that Gibrat’s Law no longer holds; instead, the largest banks grow the fastest, though that has slowed down recently.

The authors forecast that the number of U.S. banks is likely to continue dropping, but soon may level off. This prediction is based primarily on observations from the (admittedly brief) period from 2000 to 2005. “If the present trends continue, the transition in banking that began in the 1980s is slowing down and coming to an end,” the authors write. And despite the prediction of a “barbell” banking industry structure — with many big and small banks, but very few midsized ones — the projected remaining 5,000 banks probably won’t have such a shape. Instead, Prescott and Janicki see “more midsized banks than large banks” — much as it is now shaped.

All of this helps lay the factual foundation for a theory of how many banks there will be in the future, and how many of those will be big, medium, or small in size. Such a theory can establish the costs and benefits of past limits on bank size and evaluate policies that affect bank size distribution.

“A theory of the changes in bank size distribution needs an explanation of why the size dynamics changed and by how much,” the authors conclude. “The natural place to start is with an understanding of how removals to growth and size limits change the growth rates of different size banks.”

“How Resilient Is the Modern Economy to Energy Price Shocks?” Rajeev Dhawan and Karsten Jeske, Federal Reserve Bank of Atlanta *Economic Review*, Third Quarter 2006, vol. 91, no. 3, pp. 21-32.

One of the longer-running debates in modern economics centers on whether business cycle fluctuations are more likely to be triggered by energy price shocks or productivity shocks. On one side, Dhawan and Jeske argue, are the empiricists who claim that energy price shocks are the primary cause, while on the other are economists whose “dynamic stochastic general equilibrium” models suggest that we should look at shocks to total factor productivity (TFP) instead.

In a new paper, the authors reconcile the two arguments by building a model that takes into account energy use in the production function. They find that big changes in energy prices *can* have business cycle effects if they also affect the underlying productivity trend. That appears to have been the case from 1970 to 1985. But since then, it is harder to identify how productivity has been affected by energy price shocks.

But the economy is not recession-proof. “While the economy is more resilient to energy price shocks than before 1985, it is still subject to fluctuations in TFP unrelated to energy price hikes.”

“The Relocation Decisions of Working Couples.” Jonathan F. Pingle, Federal Reserve Board of Governors Finance and Economics Discussion Series Working Paper 2006-33, August 2006.

The United States has about 33 million households with both spouses working outside of the home. This poses a problem. If one spouse gets a job offer in another city, acceptance tends to be contingent on whether the other spouse can likewise find gainful employment. Increasingly, couples move only when one spouse gets a big enough raise to more than offset the other spouse’s lost earnings.

Jonathan Pingle, an economist with the Federal Reserve Board of Governors, finds that early-career location decisions are especially important. “[C]ities attracting young, high income couples will likely keep them — cities like Washington, San Francisco, or Seattle,” Pingle writes. “As migration continues to decline, this could sort the most productive labor away from cities that cannot find ways of attracting the young and the educated before they marry, form dual-worker households, or have children — after which relocation becomes difficult even if one of the spouses gets a good job offer elsewhere.” **RF**