Rise of Bank Competition: Evidence from Banking Deregulation in China

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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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This paper
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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
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
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 be 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
Rise of Bank Competition: Banking Deregulation in China 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
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 it's 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)
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
• 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