

Directions: Please limit the written response to 6 pages of text, plus an executive summary of up to 1 page. References and up to 3 pages of figures/tables do not count against this limit. Figures and tables should be self-contained and included at the end of the document. Text should be single spaced in Times New Roman font, 12 pt, with 1” margins on all sides of the page.

Question: What are the effects of community banks on local economic development?

In recent decades, both the number and overall market share of community banks—small, single-market, local institutions—have declined significantly. This decline has occurred through a variety of channels, including mergers and bank failures. While the decline in community banking has been extensively documented, its consequences for local economies are not well understood. On the one hand, community banks may forge close relationships with local borrowers, including small businesses. Such “relationship lending” may facilitate a more efficient allocation of capital because of loan officers’ familiarity with local borrowers and localized decision-making. On the other hand, entry of larger banks into local markets could be beneficial due to, for example, improved diversification of financial institution assets, efficiency in producing banking services, institutional stability, and access to resources.

Your goal is to provide a conceptual analysis of the effects of the decline in community banking on local economies and communities, supporting your ideas with graphical or other evidence. Described below are examples of available data sources that could help illustrate your arguments, but you may deploy other publicly-available data as needed. The Federal Deposit Insurance Corporation (FDIC) releases (1) quarterly data on the business behavior of community, regional, and national banks through Call Reports, which are available from the Federal Financial Institutions Examination Council (FFIEC), and (2) annual data on the location of physical bank offices through the Summary of Deposits. The U.S. Bureau of Economic Analysis (BEA) releases county-level data on economic activity and employment as part of the Regional Economic Accounts series.

Part I: Conceptual Framework

Develop a concise conceptual framework that discusses potential ways in which the decline in community banking could affect outcome measures of your choosing. Use this framework to motivate hypotheses to illustrate with data, as described in the following sections. You can focus on economic, demographic, and socioeconomic outcomes, including employment, personal income, access to credit, or other important measures.

The following are some examples of issues that your conceptual framework could address.

- What are some potential effects on communities that might arise from a strong presence of community banks?
- What should we expect to see in the data in areas where larger banking institutions have a large market presence relative to community banks?
- Which of these effects can we measure in the available data?
- What laws or regulations in the state where your college or university is located might affect the ways that community banks can affect the local economy?

Part II: Empirical Analysis

Using the data available through the FFIEC, FDIC, BEA, and/or other publicly-available sources, describe the trends over time and across areas in the outcome measures proposed in the previous section.

In your analysis, it may be helpful to compare areas where community banks have a strong presence relative to areas where community banks do not have a strong presence. Depending on how you structure your analysis, you may choose to perform your analysis including all areas and/or focus on specific areas where you may be more familiar with local regulations and the economic environment.

Part III: Interpreting the Empirical Findings

Describe and discuss how the patterns you have identified support your hypotheses. It may be helpful to address the following questions, though you are encouraged to develop and address questions that relate to your specific approach.

- For the measures you examined, are there differences between areas where community banks have a strong presence and areas where community banks do not have a strong presence?
- Are there differences within the set of areas where community banks have a strong presence?
- For areas where community banks have a strong presence, are there area or bank characteristics that appear to amplify or weaken the effects of community banks?

It is important to assess your findings critically and understand the limitations of your analysis. In this regard, it may be helpful to address the following questions.

- Why might your findings be related to a strong presence of community banks?
- Why might they not be related to community banks, i.e., what other factors could explain these findings?
- What factors should be considered when determining if a difference between areas is related to community banking?

Part IV: Policy Implications

The FDIC, working with other banking regulators, examines and supervises thousands of banks for safety and soundness and compliance with consumer protection laws. The FDIC also reviews and approves applications for deposit insurance, an important step in opening a new bank. Include in your write-up a consideration of the role that the FDIC has in regulating the banking sector.

- Do your results suggest a course of action for bank regulators such as the FDIC? If yes, explain this course. If not, explain why inaction is the best response.
- If the FDIC implemented your policy recommendations, what might the impact be on consumers and local economies?