Masking the truth or softening the blow?
U.S. banking deregulation and sectoral reallocation after the China trade shock

Abstract

We study how state-level banking deregulation during the 1980s affected the sectoral reallocation between tradable and non-tradable industries a decade later, between 1990 and 2007, following the China trade shock.
States that opened their local banking markets earlier were effectively financially more integrated by the 1990s.
Based on a simple theoretical model, we argue that financially more open states should see a swifter reallocation between tradable (import-exposed) and non-tradable industries.
The model emphasizes the stabilizing effect of financial integration on non-tradable demand by households: faced with an adverse shocks to the terms of trade, households in more open states can more easily smooth consumption.
This stabilizes consumer demand for and prices of non-tradables and thus facilitates the sectoral reallocation from tradable industries exposed to import competition towards the non-tradable sector. Consistent with the model predictions, we find that financially more open states and commuter zones saw a stronger and swifter drop in tradable output and employment and an bigger increase in non-tradable output and employment while non-tradable wages and prices—and in particular housing prices—dropped less in more financially integrated states. Our findings illustrate the role of better access to finance for households in the adjustment to spillovers from external trade shocks in heterogeneous monetary unions.

The paper is joint work with Liliya Khabibulina

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