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Local liquidity constraints: What place for central bank regional policy? The French experience during the Belle Époque (1880–1913)☆

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Abstract

This paper examines whether improved geographical access to the central bank contributed to local credit development in France during the Belle Époque (1880–1913). I use a new data set of credit by administrative area (département) in order to test the effect of the Bank of France network of branches on an indicator of local "credit development". The results suggest that, despite potential market frictions created by the Bank of France, the positive effects of the network of its branches outweighed the negative ones.

JEL classifications: E51; E58; G21; N23; N13; O16
Keywords: Central bank branches; Liquidity constraints; Credit development; Banking policy

1 . Introduction

Drawing on Joseph Schumpeter's insights, economists have recently attempted to assess the role of finance in economic development. The literature commonly argues that financial development generates growth and that barriers to the good development of financial systems can depress capital markets (Levine, 2005). In this respect, the effect of central bank intervention on the credit market turns out to be critical. While central bank supervision helps to prevent banking crises, central bank lending should also assist the market at moments of liquidity constraint. In both cases the central bank aims to prevent market imperfections from depressing credit conditions. On the other hand, supervision comes with new banking restrictions, while lending can distort the market and engender banking rents. Whether central bank interventions have positive or negative effects on financial development is thus an open question.

The French experience of the *Belle Époque* (1880–1914) is particularly useful for shedding light on the issue. As in Japan (Mitchener and Ohnuki, 2009), Austria (Jobst, 2010) and Belgium (Ugolini, forthcoming) among other countries, the French central bank, usually at the request of local banks and municipalities, opened a large network of branches (*succursales* and *bureaux auxiliaires*) to collect information, supervise banks and

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provide liquidity locally through the rediscounting of commercial and credit papers,[1] and advances on securities (*avances sur titres*). Although the Bank of France (BoF henceforth) network of branches proved particularly useful in collecting local information, local interventions were not necessarily good for local credit markets. Central bank branch detractors argue that central bank use of privileges can crowd out other banking institutions, reduce banking competition and restrict credit, especially to non-strategic sectors (Lescure, 2003).[2] This fear seems justified since the BoF could – although only in a few circumstances – discount bills directly in the market (Lescure, 2003), support inefficient bankers (see Collot (1999) for an example) and discriminate among banks as to access to its discount window.

Previous enquiries (see Nishimura, 1995; Plessis, 1999; Gonjo, 2003; Baubeau, 2004 among others) cited evidence of BoF branch abilities to support local banking markets. In particular, the literature suggests that BoF branches encouraged local and regional bank lending operations and thereby increased firms' access to credit. However, none of these studies account quantitatively for market frictions created by the BoF. Likewise, the lack of comprehensive data about the local volume of credits hampers systematic analysis. For instance, Nishimura (1995) observed a small sample of branches to assess the impact of BoF local policy on credit supply. Given the diverse nature of the French economy, an exhaustive examination of the BoF network is needed. Exhaustive data for each *département* should help to avoid these problems and to assess the impact of the BoF network of branches on local credit development.

This paper proposes two new points in this regard. First, it presents a new data set for an indicator of credit development for each *département*. Second, it assesses the role of the BoF network of branches upon this indicator. The empirical evaluation uses panel data analysis on a spatial basis. It first considers the correlation between the number of BoF branches of each *département* and credit development. Control variables are also added to account for other factors, such as the size of local economies and local businesses. However, as some endogenous effect may remain, identification issues may prevent the explanatory variable from being totally exogenous. I therefore use instrumental variable techniques to eliminate potential biases. The instruments appear robust and respect all basic conditions of effectiveness of instrumental variable analysis. The results finally converge to demonstrate that the positive effects of the BoF network of branches on the credit market outweigh the negative ones.

This result is not unconnected to the debate about the role of central bank supervision and discount policy. Unlike Goodfriend and King's (1988) conclusions, the banking policy proves to be useful when relationship lending is a key feature of banking activities. As a matter of fact, the prominence of relationship lending can impede interbank private arrangements (Freixas and Hotlhausen, 2005) and result in liquidity constraints, especially for small banks that use private information more intensively (Kashyap and Stein, 2000; Bindseil et al., 2009). This leaves more room for discount window operations, the effect of which hardly distort the market so long as central banks are well informed about the banks to which they lend (Acharya et al., 2012).

The rest of the paper proceeds as follows: Section 2 looks at the historical background of the French banking system; Section 3 presents the data on credit development; Section 4 provides econometric specifications and results; Section 5 proposes estimations and robustness checks, and Section 6 presents the conclusions.

2. The French banking system of the Belle Époque

The French banking system of the *Belle Époque* (1880–1914) was essentially a combination of three major players[3]: local and regional banks, deposit (network) banks (Crédit Lyonnais, Société Générale, Comptoir National d'Escompte and Crédit Industriel et Commercial[4]) and the Bank of France. This section provides some general information about, and the basic interactions between, banking actors that help the enquiry into the potential influence of the BoF branches upon local credit development.

[1] Credit papers differ from commercial papers in that they are not tied to commercial transactions. Credit papers are often drafted directly by the bank to meet borrowers' needs. They can be rolled over and used to finance firms' long-term projects. In this respect, credit papers are not backed by real transactions and are subject to the risk of immobilisation.

[2] See for example what is said about the Bank of England in Clapham (1944) and Ziegler (1990). See also Mitchener and Ohnuki (2009) in the case of Japan.

[3] Notaries and Crédit Foncier could be added to this list, but they do not tie in with the topic we are addressing here (see Hoffman et al., 2001).

[4] It is worth noting that Crédit Industriel et Commercial is a very Parisian bank and has few provincial branches in this regard. This is why we look here at only the three other deposit banks.