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PII:	S0148-6195(15)00063-6
DOI:	http://dx.doi.org/doi:10.1016/j.jeconbus.2015.11.002
Reference:	JEB 5729
To appear in:	*Journal of Economics and Business*
Received date:	12-10-2014
Revised date:	16-10-2015
Accepted date:	18-11-2015

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October 12, 2015

Abstract

We exploit the cross-state, cross-time variation in bank tangible capital ratios—brought about by bank branch deregulation on a state-by-state basis—to identify the effects of bank capital pressures on employment and firm dynamics over two waves of changes in bank capital regulation. We show that stronger capital pressures temporarily slowed down growth in employment in industries that depend on external finance, retarding growth in the average size of firms rather than in the number of firms. Such effects were particularly strong for smaller firms that may not have access to national capital and bank loan markets. Our findings indicate that a tightening of capital requirements may have significant real effects, in part, because of the lack of substitutes for bank loans.

JEL Classification: G21, G28, G30, J20, L25
Keywords: bank capital ratios, bank capital regulation, loan substitutability, employment, firm dynamics.

We are grateful to an anonymous referee for valuable comments and suggestions. We thank Elizabeth Kiser for access to the Summary of Deposits (SOD) data. The views expressed in this paper are solely the responsibility of the authors and should not be interpreted as reflecting the views of the Board of Governors of the Federal Reserve System or of anyone else associated with the Federal Reserve System.

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