On the Welfare Cost of Bank Concentration

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We build a search model of bank concentration. Banks have incentives to overbranch to improve their position in bargaining. This generates a scale inefficiency and over-concentration of banks. We find that this friction also produces over-concentration on the goods market, lowering aggregate output and welfare. We calibrate the model using data on the distribution of branches across banks in the US and available estimates on X-efficiency in the banking sector to assess the quantitative importance of this effect. We find that aggregate output would increase by 2.4% had the scale inefficiency been absent, while loan rates would decrease by 1.2%.