



XXXI Convegno di studio su
**LA BANCA NEL NUOVO ORDINAMENTO EUROPEO:
LUCI E OMBRE**



Banking Crises: Where Does The Pendulum Stand?

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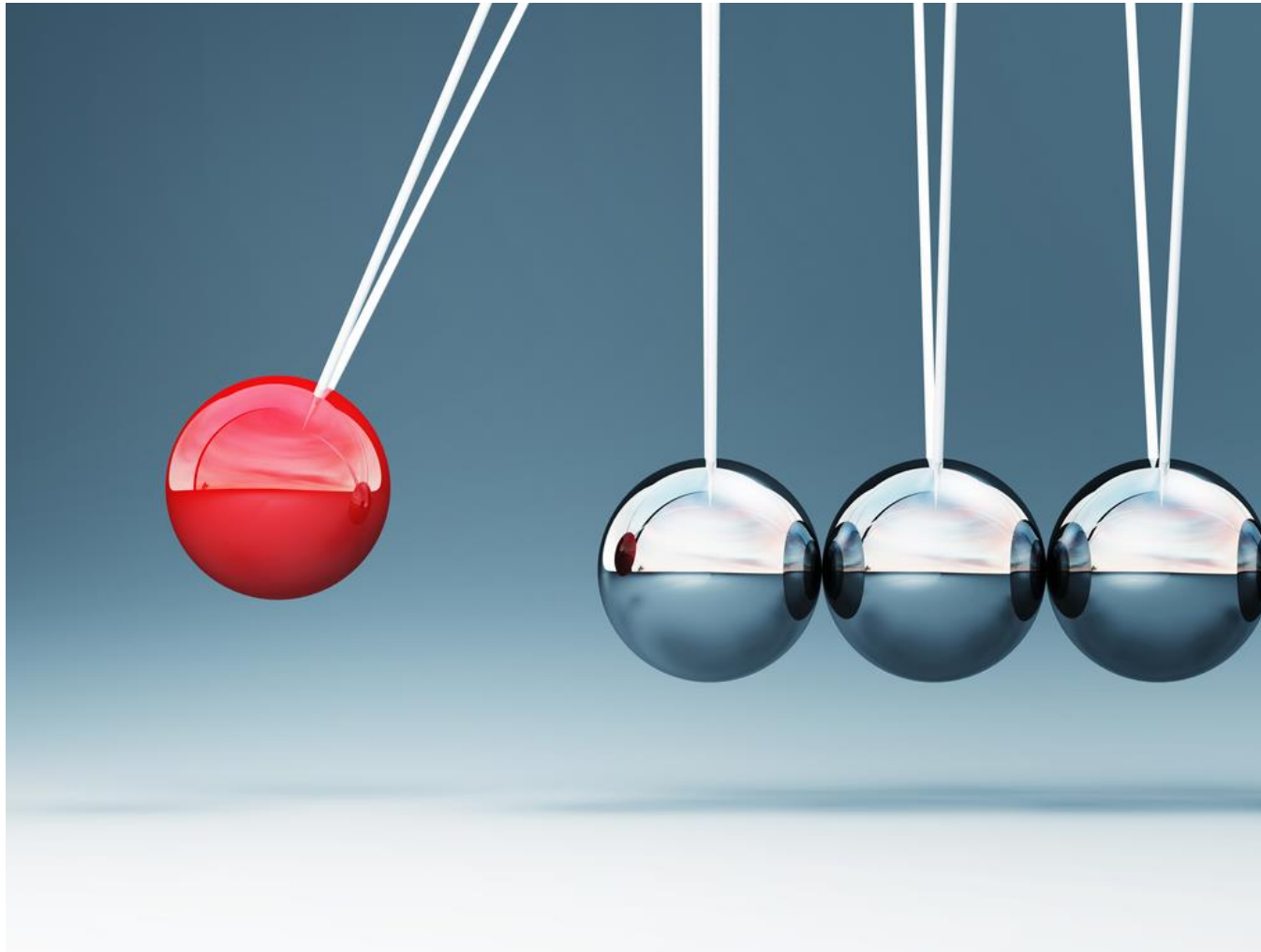
September 2017



Motivation

- ❑ The **specialness** of banking:
- ❑ **Liabilities** as **medium of exchange**
- ❑ **Systemic Risk**
- ❑ How to address it?

Motivation: Where Does The Pendulum Stand?



Banking Regulation

- Two **approaches** ...
- Three **periods** ...

Before the Great Depression ...

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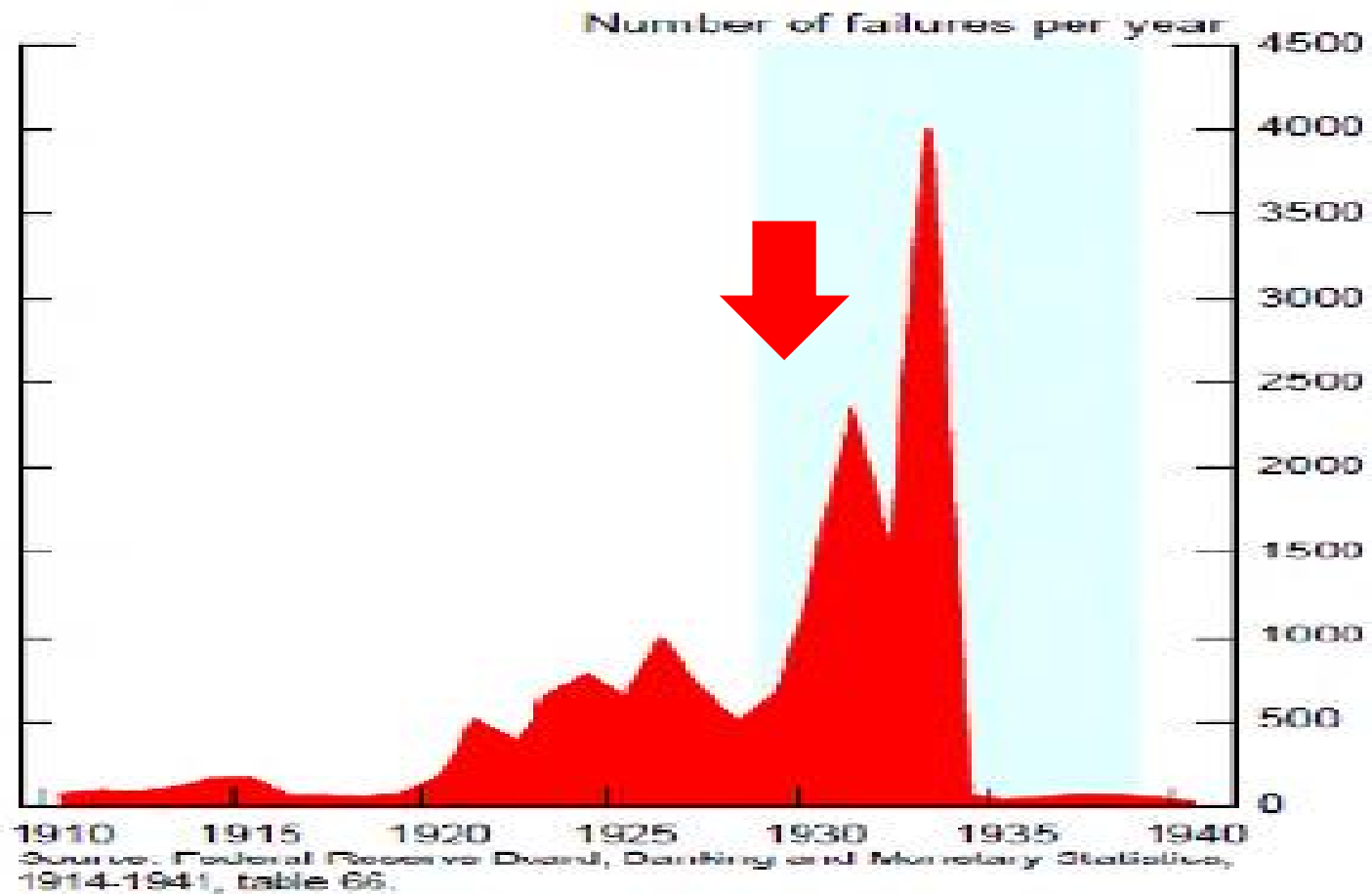


The Great Depression



Systemic Risk

Bank Failures



Structural Regulation

- ❑ Key Assumption: in Banking Risks **can** be **unpredictable**
- ❑ Therefore it is necessary to use **bans**:
- ❑ In defining banking and financial **businesses**
- ❑ In limiting the bank degree of freedom in setting their **business prices** (interest rates) and/or their **business products**

The Bank Balance Sheet

Examples:

- 1) Compulsory Reserve Requirement
- 2) Ceilings on Loan
- 3) Ceilings on Interest Rates
- 4) Business Banning

Other Names:

Structural and Conduct Regulation

Financial Repression:
Constraints on Competition

ASSETS	LIABILITIES AND NET WORTH
CEILINGS & BANNING on business and prices	
“ LOANS (SUPPLY)	* DEPOSITS
“ (FREE) RESERVES	
“ COMPULSORY RESERVES	* CAPITAL:

Banking Stability

*Proportion of Countries with Banking Crises, 1900-2008
Weighted by Their Share of World Income*



The Great Moderation



Prudential Regulation

- Key Assumption: In Banking Risks **are** ever **predictable** and measurable
- Therefore it is sufficient to use **rules on the banking capital:**
- In order to exploit the relationships between risks and capital requirements

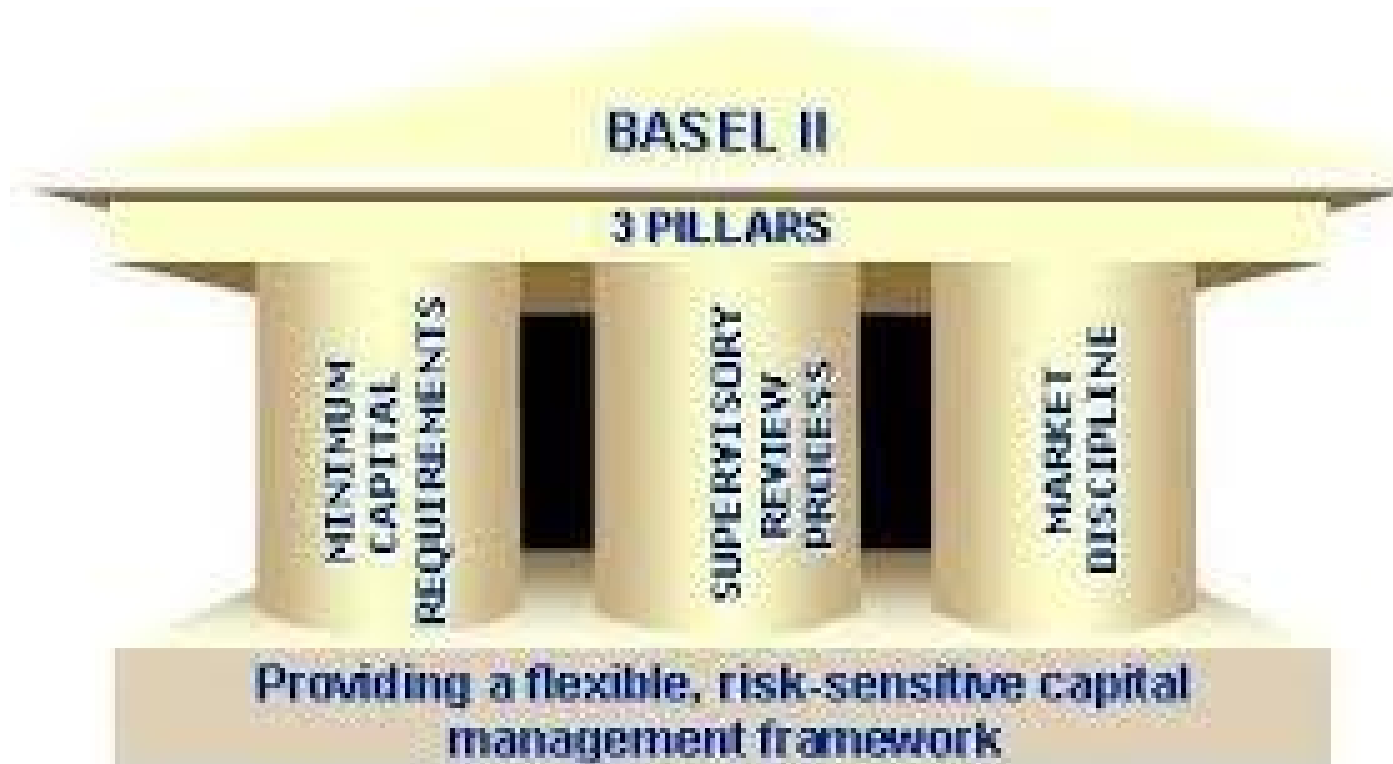
The Bank Balance Sheet

Examples:

- 1) Capital requirements
- 2) Liquidity requirements

ASSETS	LIABILITIES AND NET WORTH
“ LOANS (SUPPLY) “ (FREE) RESERVES “	* DEPOSITS * CAPITAL REQUIREMENTS

The Basle Standards



The Pendulum

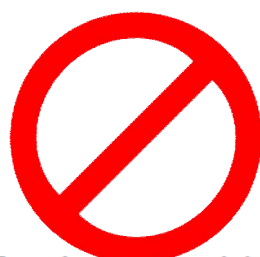
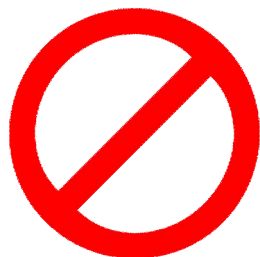


Table 2: Trends in Financial Regulation

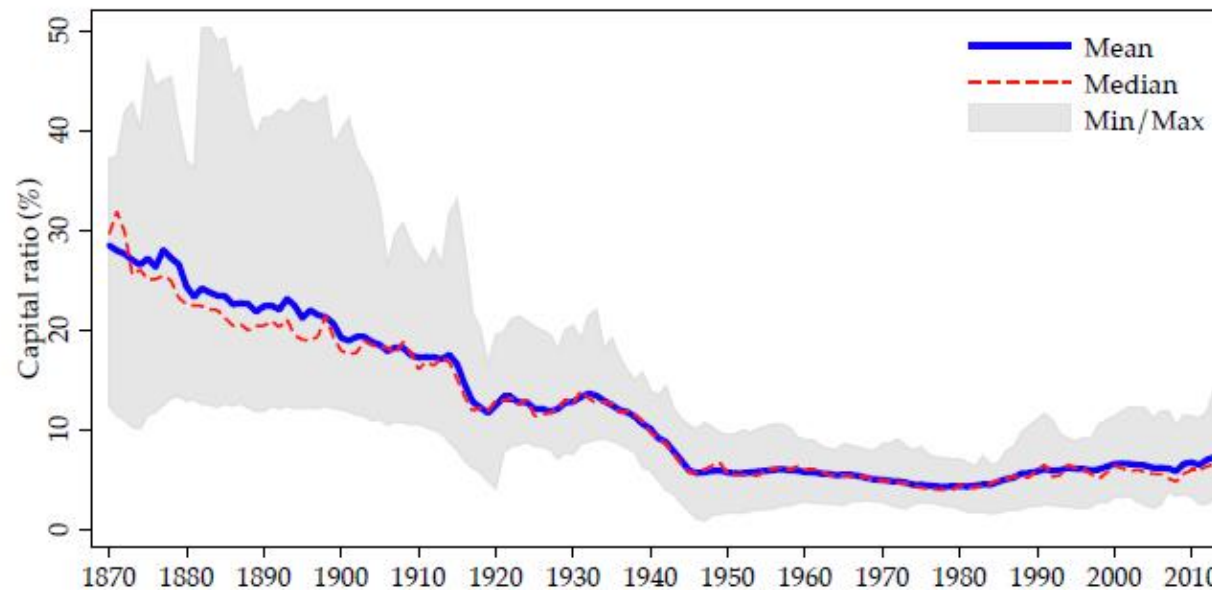
Structural Regulations		Conduct Regulations		Prudential Regulations	
Functional separation of institutions	↓	Regulations of bank's deposit and lending rates	↓	Deposit insurance	=↑
Entry restrictions	↓	Regulations of fees and commissions	↓	Discount window	=↑
Ownership restrictions	↓	Credit quotas	↓	Restriction on asset concentrations	↓=
Discriminatory rules against foreign investors	↓	Branching limitations	↓	Information disclosure	↑
				Solvency ratios	↑

Noted: Table is based on Vesala (1993), who in turn derived it from Diamond and Dybvig (1986), and Gual and Neven (1992).

Source: Classens 2016

Prudential Regulation = Financial Deregulation

Figure 1: Capital ratio, averages by year for 17 countries, full sample.



Notes: The blue line plots the mean of capital ratios in the sample countries between 1870 and 2013. The red line refers to the median of the sample countries. The grey area is the min-max range for the 17 countries in our sample.

Source: Jorda, Richter, schularick, Taylor, NBER, 2017

Prudential Regulation = Financial Deregulation

- Prudential Regulation =
- Bankers enjoy more degrees of freedom in setting their **business prices** (interest rates or fees) and/or their **business designs**
- Creativity + Δ **Technology** and/or Δ **Rules** = Financial Innovation
- Finance during the GM ...

A) More Finance

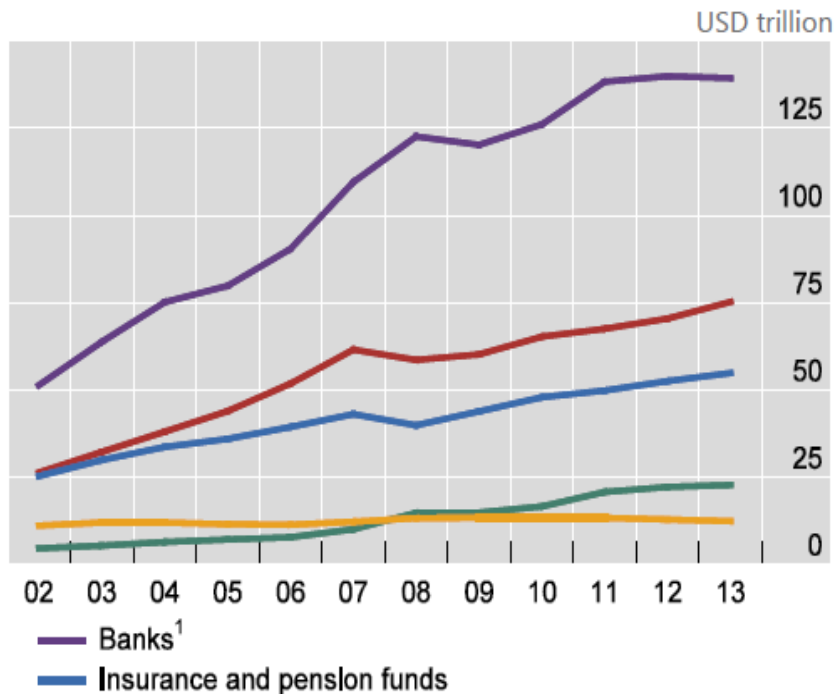
Assets of financial intermediaries

20 jurisdictions and euro area

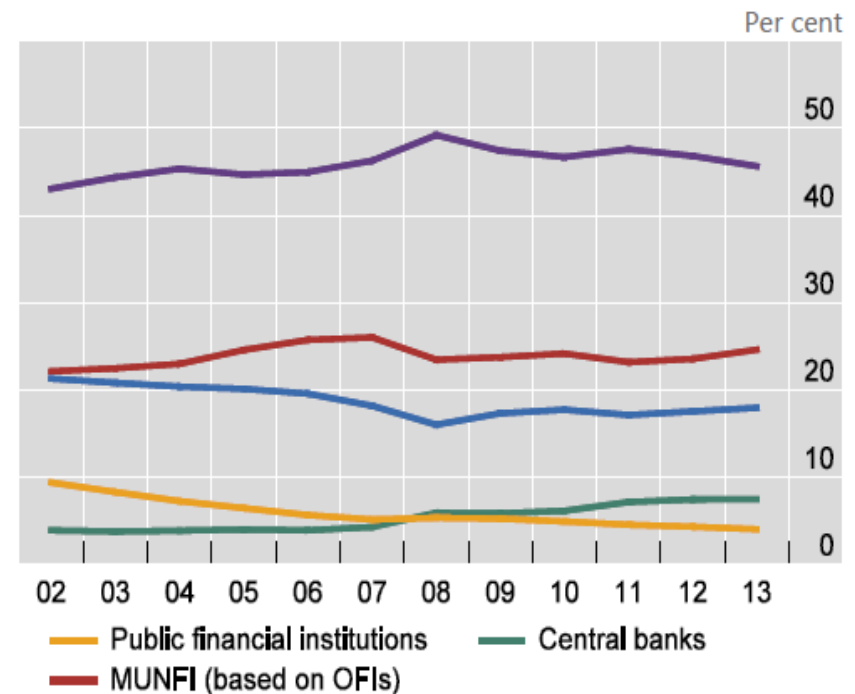
Exhibit 2-1

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Total financial assets

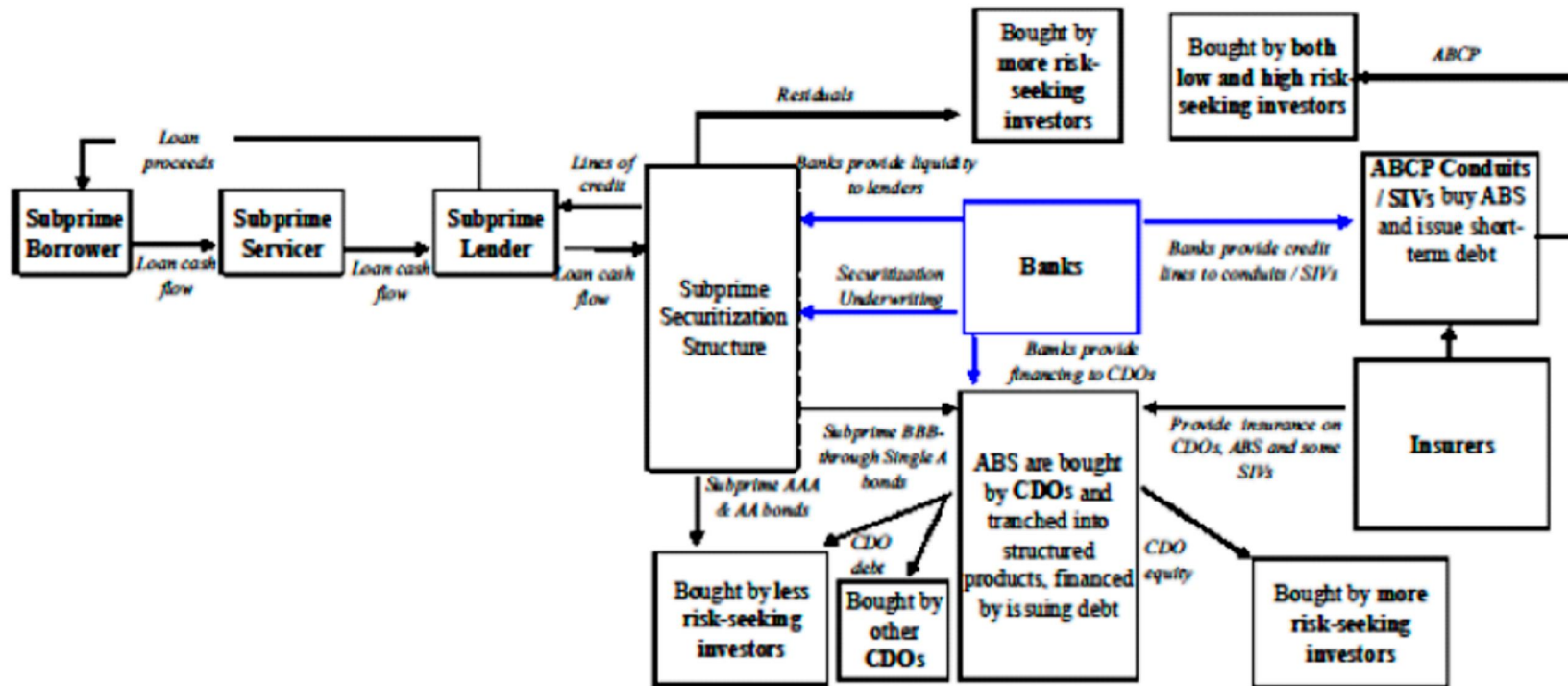


Share of total financial assets



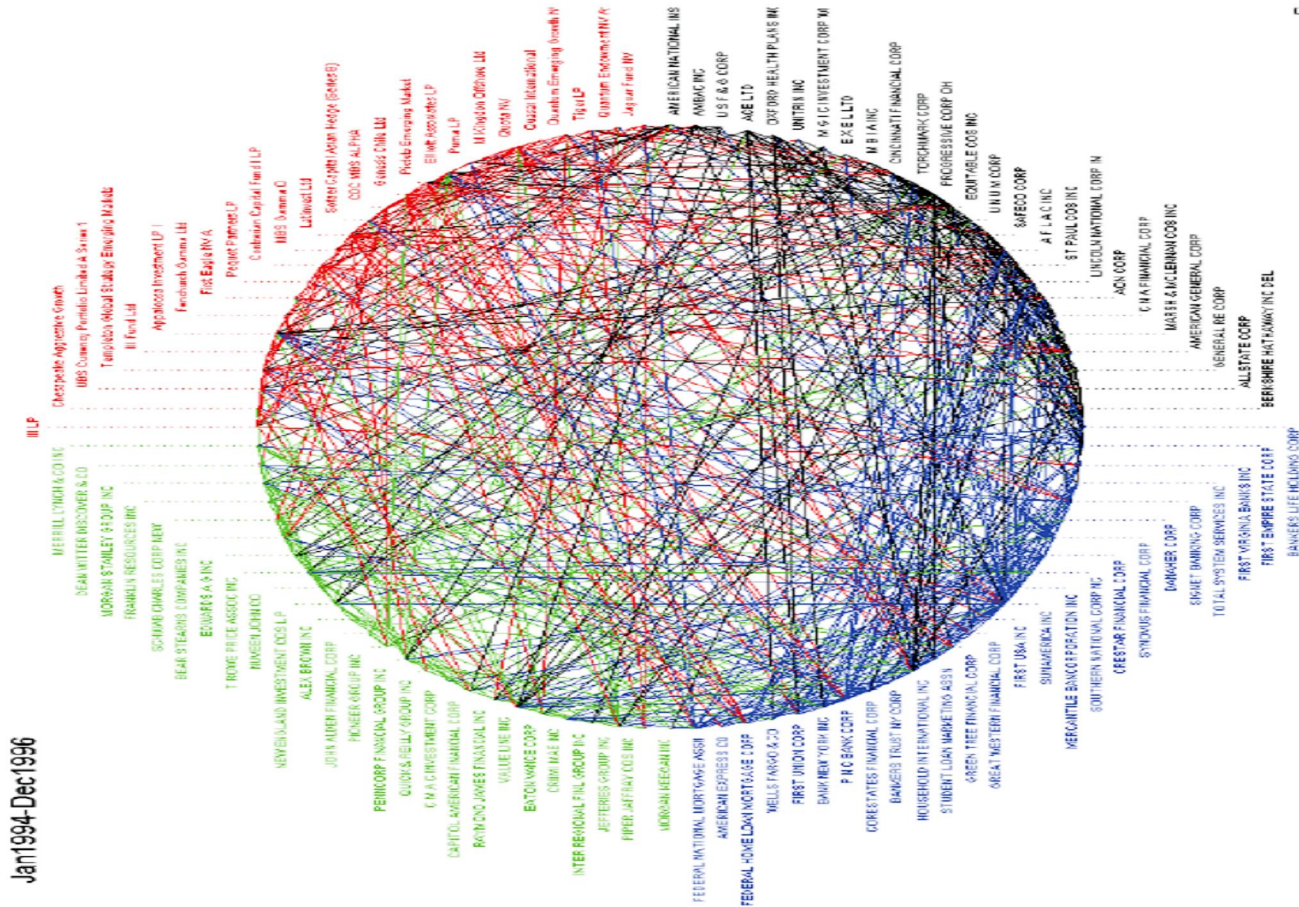
B) Complexity

Figure 2. A Visual Sense of the Complexity: From Mortgages to Securities



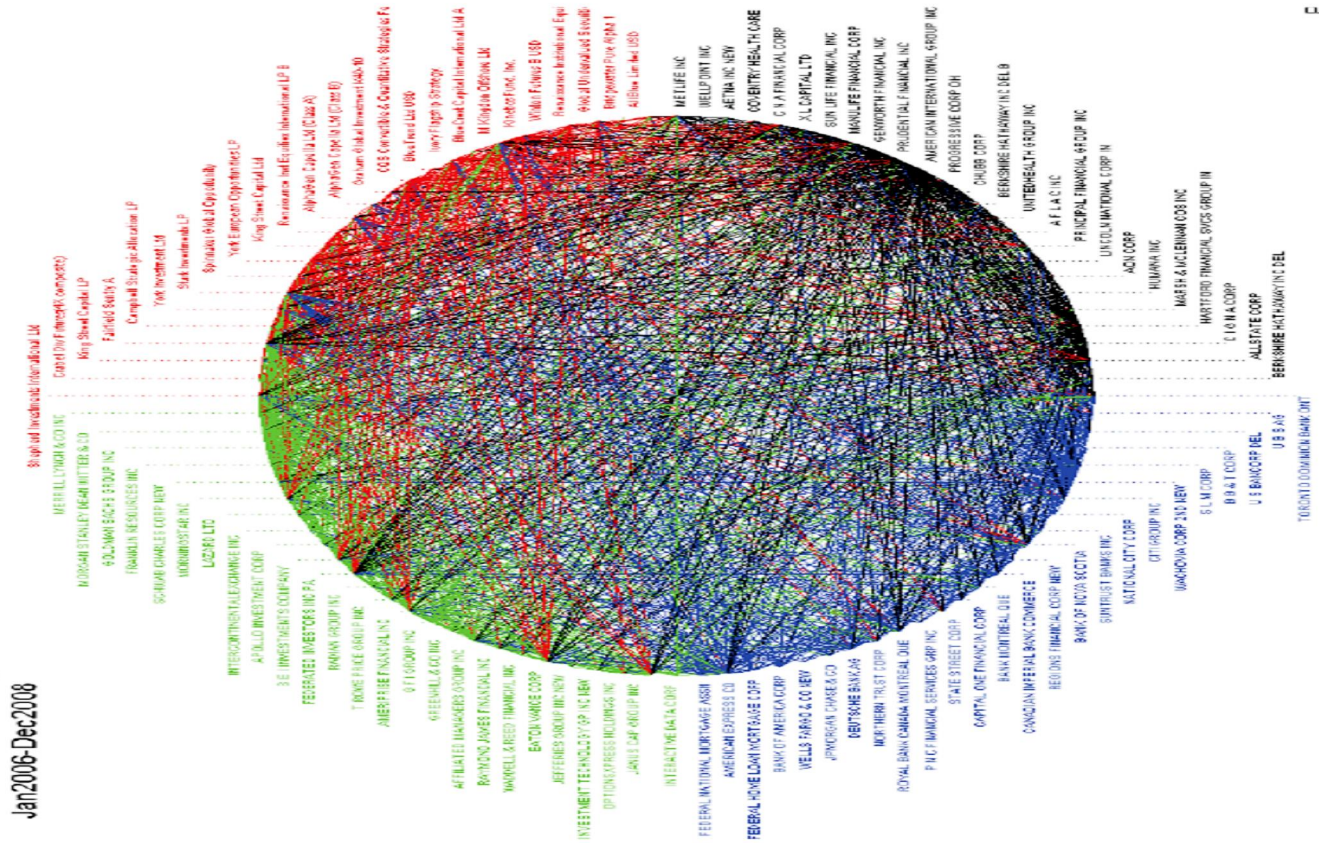
Source. Adapted from Figure 1.10: Mortgage Market Flows and Risk Exposures, Chapter 1, p. 11, Global Financial Stability Report, October 2007

C) Interconnections: Markets in the '90 ...



Billio et al., WP CaqFoscari, 2012

C) Interconnections: Markets ten years later ...



Summing Up

- “ The **Great Moderation** = a **NICE** period
- “ **NICE** = Non inflationary consistently expansionary = stable growth with low inflation
- “ With **high private debt** = a **LEVERAGED NICE** period
- “ The Great Moderation: **Pros** and **Cons** ...

GM, i.e. The Quiet before the Storm ...

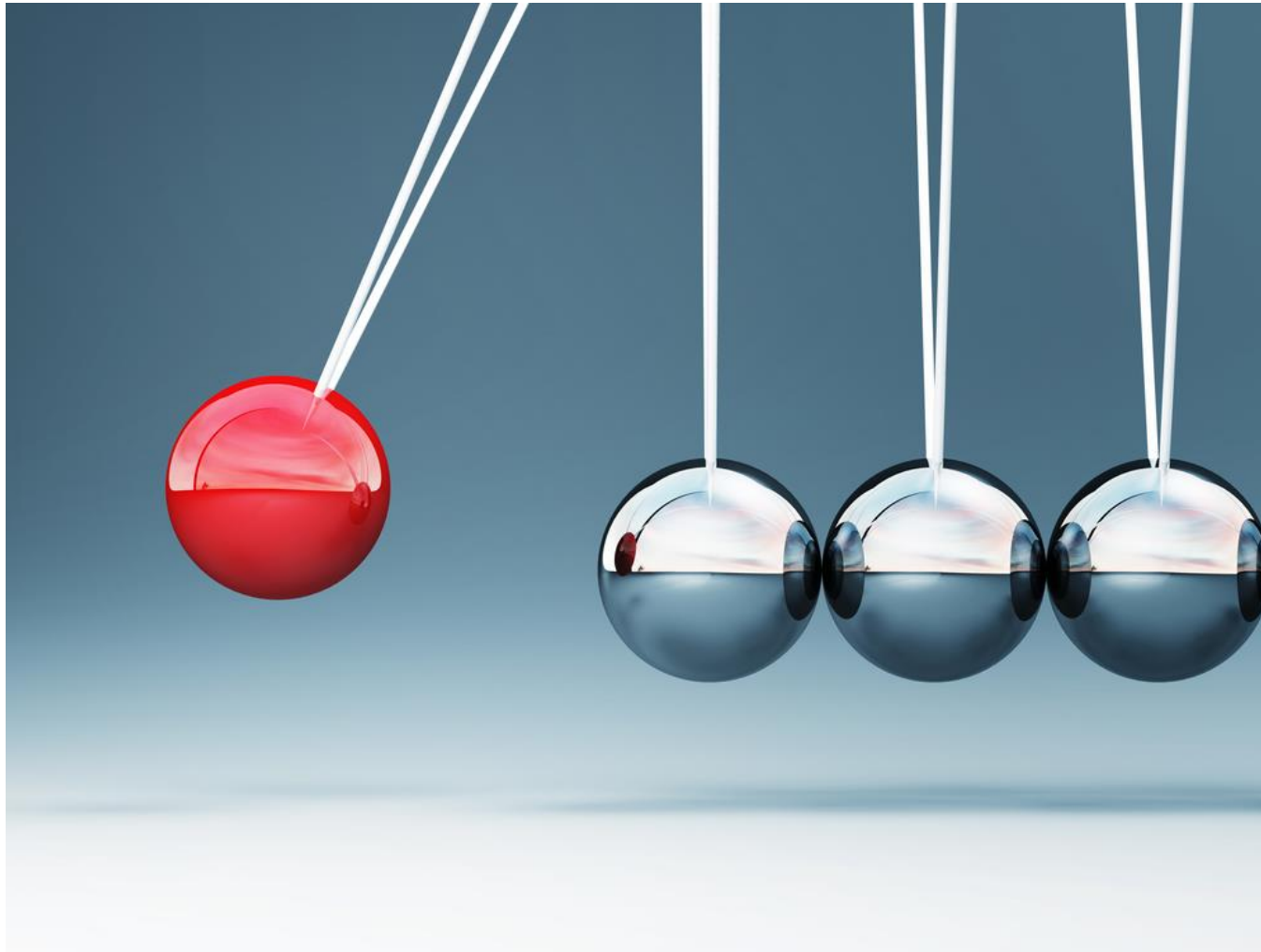
FINANCIAL
IMBALANCES



... The Storm (GC)



Today: Where Does The Pendulum Stand?



Today: Where Do We Stand?

Table 1

	Volcker	Liikanen	Vickers
Broad approach	Institutional separation of commercial banking and certain investment activities	Subsidiarisation: proprietary and higher-risk trading activity have to be placed in a separate legal entity	Ring-fencing: structural separation of activities via a ring fence for retail banks
Deposit-taking institution may:			
- deal as principal in securities and derivatives	No	No	No
- engage in market-making	Yes	No	No
- perform underwriting business	Yes ¹	Yes	Restricted
- hold non-trading exposures to other financial intermediaries	Unrestricted	Unrestricted	Restricted (inside the group)
Holding company with banking and trading subsidiaries	Not permitted	Permitted	Permitted
Geographical restrictions	No	No	Limitations for ring-fenced banks in the UK to provide services outside the European Economic Area

¹ Underwriting in response to client/counterparty demand.

Source: Gambacorta & van Rixtel, 2013 BIS WP 412

Which Pendulum?

- “ **Main** Lesson: **One Size** doesn't Fit All
- “ **Insights:**
- “ **1) Multi** tools approach: theory, empirics and institutions
- “ **2) More contamination** among Fields :
- “ **Political Science** and **Law**
- “ **Zooming on the Actors...**
- “



Polycymakers or ...

□ Welfare Maximizing

Players



Politicians

□ Career Concerned Players



Lobbies

- ❑ 1) Banks
- ❑ 2) Managers
- ❑ 3) Controlling Shareholders



In this political cartoon, Jackson destroys the Second Bank of the United States by withdrawing government deposits. As the Bank crashes, it crushes the director Nicholas Biddle (depicted as the Devil), wealthy investors (with moneybags) and the newspaper editors (surrounded by paper) who opposed Jackson on this issue. SOURCE: Library of Congress.

Bureaucracies

- 1) **Regulators:**
- A) Regulators **vs** Regulators
- B) **Capture** Regulation
- All in all ...



Prudential vs Structural Approach, or ...



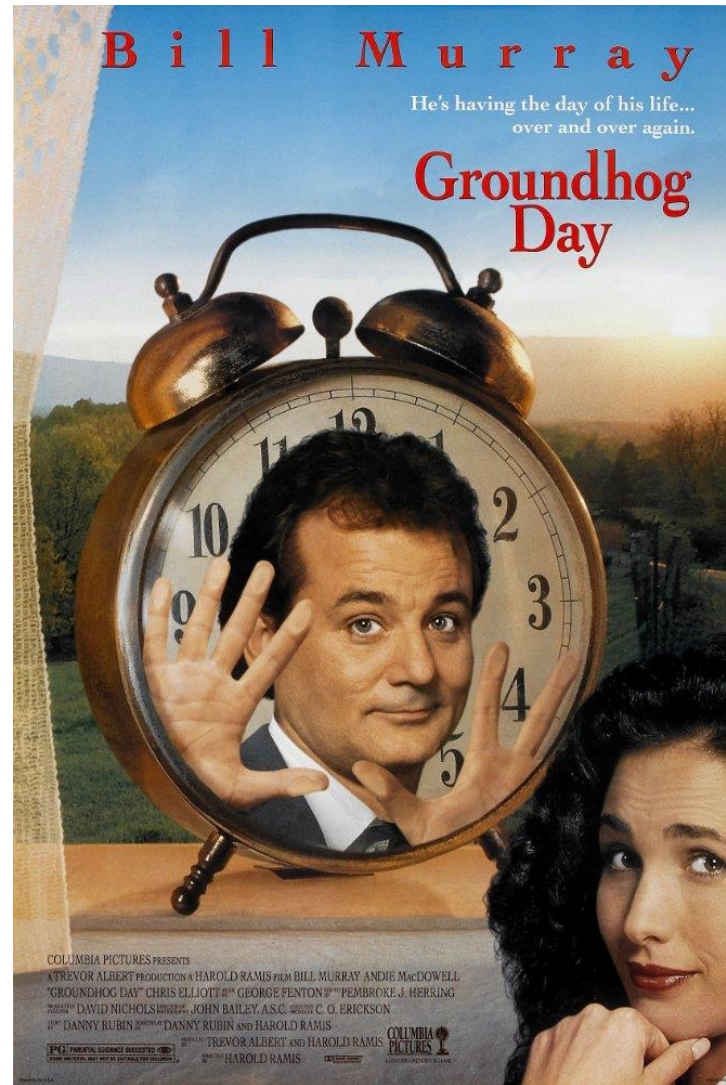
Mangrove Approach



Food for Thought

- ❑ The **specialness** of banking: **Liabilities** as **medium of exchange + Systemic Risk**
- ❑ Money = Private (Banking) Money
- ❑ Alternative Setting: More Competition between Private and Public Money
- ❑ **CBDC** = Central Bank Digital Currency

Conclusion





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