BANKING AND BANK RUNS

1. Why the standard loan contract?
   - Moral hazard
   - Costly monitoring

2. Why liquid, or fixed-term, deposits?
   - Moral hazard
   - Costly monitoring

3. Banks
   - SLC’s in both directions.
   - Balance sheet mismatch
   - Bank capital

4. Bank runs
   - The logic for the individual depositor
   - Contagion

5. Wildcat banking
   - Why it arises

6. Is there a problem?
   - The world is full of risks, needs to gather information.
   - Are these banking and lending problems specially deserving of regulatory intervention?

7. Main types of regulation or intervention
   - Bank examiners
   - Deposit insurance
   - Insurance ⇒ examiners, perhaps not ⇐.
   - Lender of last resort
   - Deposit rate ceilings
   - Limitations on bank portfolios (Reserve requirements, mortgage specialty)

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8. INCENTIVE PROBLEMS WITH REGULATION

- Bank examination, publication of results, reduces private incentives to investigate and assess bank soundness.
- Deposit insurance further reduces private incentives to investigate, and makes it optimal for bank management and depositors jointly to take on risk, at the expense of insurors.
- Lender of last resort function may encourage risk-taking.

9. SYSTEMIC RISK, EXTERNALITIES

- If default simply instantly and costlessly reallocated wealth, it could be argued that regulation and intervention is not needed.
- But in fact default is not instant and costless.
  - It can disrupt trading at a minute-by-minute or daily level.
  - It can tie up resources inefficiently for years, using lawyers and judges rather than markets to make resource allocation decisions.
  - Zombie companies, banks that support them.

10. EXAMPLES OF PROLONGED BANK CRISSES

- US S&L — an effect of deregulation?
- Japan
- Mexico?
- Indonesia?

11. DOES ANY OF THIS APPLY TO HEDGE FUNDS?

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