COMPETITION, REGULATION, AND RISK-TAKING IN BANKING

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Course Description

This course comprises three lectures covering the relationship between competition policy, prudential regulation, and the stability of the banking system. The course starts with a review of the industrial organization of banking, focusing on the determination of deposit and loan rates under different market structures that range from perfect competition to monopoly. The second lecture examines the possible existence of a trade-off between competition and financial stability, and the potential contribution of bank capital regulation to ameliorate this trade-off. The third lecture presents an overview of bank regulation from Basel I to Basel III and discusses different aspects of the new regulation such as its loan pricing effects, the rationale for the cyclical adjustment of risk-sensitive capital requirements, and the optimal regulation of liquidity risk.

Course Outline

1. The Industrial Organization of Banking

1.1. The perfect competition model
1.2. Introducing reserve and capital requirements
1.3. The model with local monopoly banks
1.4. Cournot and Bertrand competition
1.5. Monopolistic competition

2. Capital Requirements, Market Power, and Bank Risk

2.1. Capital requirements and bank risk-taking
2.2. Competition and bank risk-taking
2.3. Charter values and bank risk-taking
2.4. An alternative view

3. The Regulation of the Basel Committee

3.1. From Basel I to Basel III
3.2. Loan pricing under Basel capital requirements
3.3. Cyclical adjustment of capital requirements
3.4. Optimal regulation of liquidity risk

Reading List

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