

Discussion of Thien T. Nguyen

*‘Bank Capital Requirements: A
Quantitative Analysis’*

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Contribution

- Explore the quantitative effects of capital requirements in a general equilibrium model with endogenously determined aggregate growth.
- Optimal capital is (at least) 8% of Tier 1 capital over total assets.
- Compared to the baseline case of a 4% requirement, it improves welfare by 1.1% of lifetime consumption.

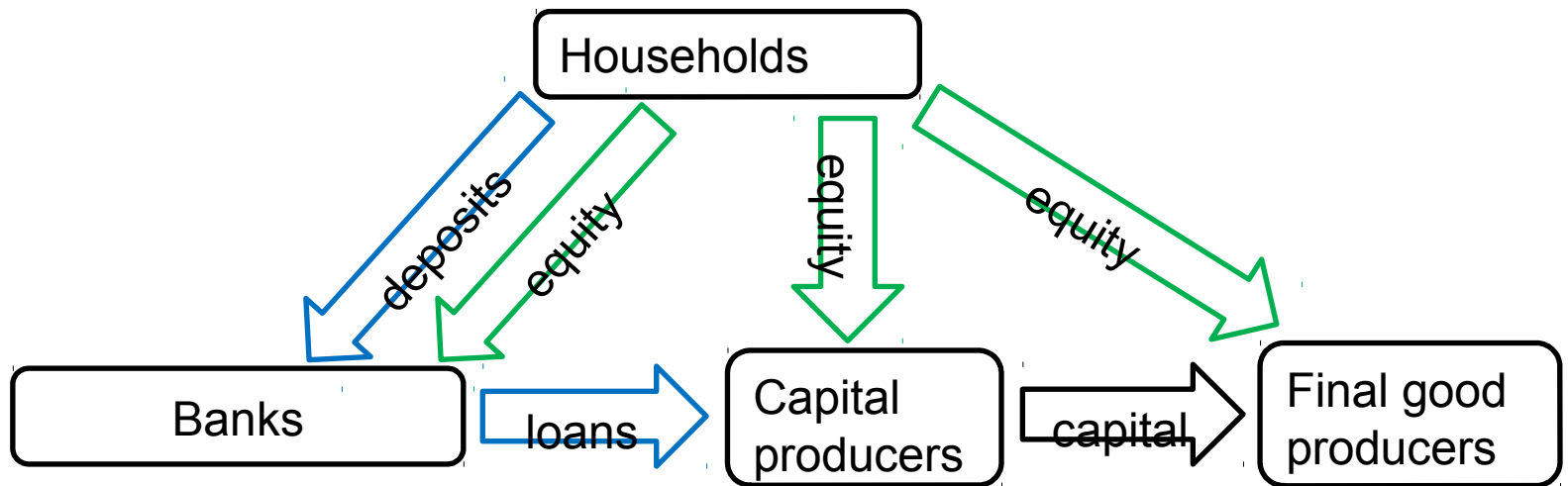
Nice to get to quantitative assessment in GE framework

⇒ ...robustness depends on model, and fitting model to data

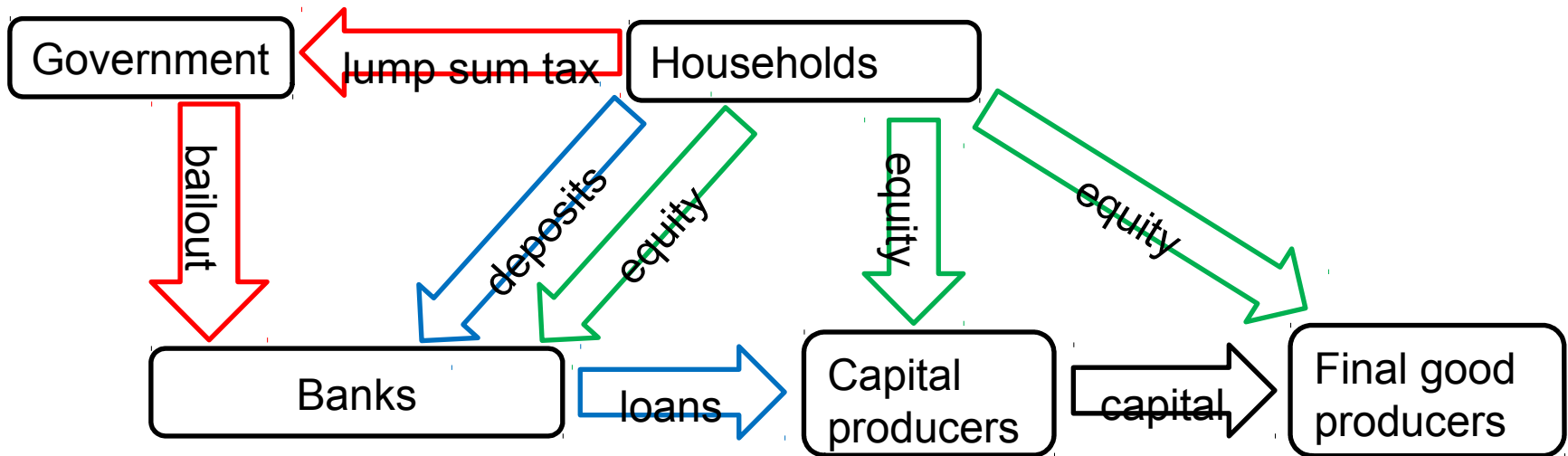
Model summary

- Four sectors: households, final good producers, capital good producers, banks.
- Banks lend to capital good producers, which are of two types: normal vs risky (introducing risk shifting)
- Final good producers face “endogenous growth” externality
 - underinvestment tendency=rationale for subsidized credit
- Deposit do not fully reflect the risk due to bailouts.
- Bailouts happen with exogenous probability
 - A bailed out bank continues to operate.

Model



Model



Intuition

The key mechanisms that determine the optimal level of capital requirements are

- creating ‘skin in the game’ to prevent risk shifting
- limiting the costs of creating ‘too much skin’ $\Rightarrow$ via equity issuance costs would reduce lending
- (and further social welfare loss via endogenous growth externality $\Rightarrow$ lower lending leads to less aggregate capital).

Comments - 1

Better link with policy debate needed. E.g.:

- You say in the paper that in your model there is no difference between risk-based capital requirement and leverage ratio?? But Basle III has distinct minimum percentages for these.
- Deposit insurance issue is in principle (!) different from bail-out discussion. Bail-out suggests that TBTF is a serious concern; deposit insurance plays a role even if there is no TBTF concern.
- Why not link your paper to bail-in discussion?

Comments - 2

Bail-outs, need for restructuring, key macro concern. Not discussed or analyzed in the paper...

- After a bailout a bank continues to operate with zero net cash $\Rightarrow$ zombie bank? Does it have to raise new equity?
- Is there any difference between a bank that has been bailed out and a bank that has just entered (apart from entry costs)?
- Does a bail-out add to social welfare because a new bank would have to incur an entry cost? Does this play a role in your model?

Comments - 3

- Also expand on whether capital regulation is binding in your model. I understand it is not always...
 - Bank charter value might be deterrent against risk shifting and increasing leverage.
- In your analysis capital regulation reduces entry (and/or leads to exit). This does not have to be the case...
 - Subsidy on deposits may keep fly by night operators (low capability banks) in the market. This may discourage entry by legitimate players... and capital regulation might mitigate this...

Comments - 4

Is discussion on risk shifting different in a GE context versus a partial equilibrium context? Yes?

- In partial equilibrium analysis key focus on moral hazard. And typically in those models banks are willing to take more risk even if it offers lower returns...
 - [and this is the way it is modelled in current paper $\Rightarrow$ moral hazard leads to loss of investment productivity]
- In GE context moral hazard not necessarily bad if it just means more risk which is priced... And would be optimal if there is not enough risk taking in the economy...

Conclusion

- Very nice and let 's continue and further encourage these attempts to get to serious quantitative measurements of desired capital in banking!!