Global Banking: Endogenous Competition and Risk Taking

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Roadmap

Motivation

- Trend towards more international integration of banking markets.
- Expansion of multinational banks (MNBs) is a key driving force.
- Impact on stability?
  - Negative?: cross-border contagion, complexity, lack of supervision...
  - Positive?: this paper.
- Important to understand negative and positive channels to:
  - Guide the empirical literature.
  - Guide policy.

In a nutshell

- Intermediation model with:
  - Moral hazard in borrowing firms.
  - Imperfectly competitive banking sectors.
  - Endogenous entry of MNBs.
- Globalization = lower cost of lending in foreign country:
  - MNBs compete more aggressively on foreign markets.
  - Interest rates on loans decrease.
  - Lower rates reduce risk-taking by firms.
  - Economy is less risky.
- I like the combination of IO and financial stability a lot.
- A number of issues could be clarified.

Roadmap

The debate on MNBs

- Introduction differentiates "brick and mortar" branches/subdiaries vs. other activities (investment banking?).
- I expected a model allowing us to compare:
  - "Brick and mortar" branches to other branches/subsidiaries.
  - MNBs to non-MNBs.
- However, my interpretation of the model is that all banks are MNBs doing commercial banking.
- Difficult to understand why some activities may be harmful and not others.

Entry

- Globalization = lower cost for MNBs to lend abroad.
- This lower cost leads to more entry of MNBs operating in two countries.
- Why no entry by local banks operating in one country only?
- Why do MNBs exist at all? In the model foreign banks are just less efficient.
- No link between the two countries in the main model, except that a MNB can only enter the two markets at the same time.

MNBs and losses

- What happens if unit in F defaults but not unit in H?
  - The unit in H keeps its profit (subsidiary case)?
  - The unit in H has to reimburse depositors in F (branch case)?
- In the model the bank's payoff suggests that the two units are completely independent, which fits neither case.

Roadmap

Dynamics

- Defaults of all firms are perfectly correlated (also across countries?).
- In the deterministic case, this should lead to two types of periods:
  - No default, only an exogenous proportion ρ of banks disappear, replaced by entrants.
  - All banks default, and are all replaced by entrants.
- In the stochastic case, one could have:
  - a_t large, many banks enter and are likely to all survive.
  - a_{t+1} small, a lot of banks would like to exit, but this is not allowed (except in an extension).
- These are interesting dynamics that could be discussed more in the paper.

Modeling choices

- Theoretical argument quite simple, yet the model is too complicated to study analytically the impact of a lower μ.
- Some elements in the model seem unnecessary to the story:
  - Dynamics (none of the current results exploit them).
  - Stochastic productivity shock.
  - Imperfect competition (increasing marginal cost of lending would suffice).
- Maybe there's a way to start with a much simpler model to pin down the mechanism.
- Then the goal of the richer model should be to quantify this positive effect of MNBs (e.g., 1% reduction in operating costs for MNBs leads to a x% reduction in the probability of default of firms).

Roadmap

Welfare

- Complicated economy with many frictions:
  - Oligopoly.
  - Oligopsony.
  - Moral hazard in firms.
  - Risk-shifting in banks.
  - Externalities in entry (business-stealing effect).
  - Risk externality via entry (lowers r^L and thus risk).
- Can we start with a first-best benchmark, and maybe introduce some of these frictions sequentially?
- Some frictions are unclear, e.g. "predatory banking" seems quite harmless in the model.

Policy

- What are the policy implications of the model?
- Is the European banking union a decrease in μ?
- Should we restrict MNB expansion to certain types of activities?
- Implications for competition policy?
- Difficult to answer without a welfare criterion. For instance, MNBs can reduce risk per loan but lending expansion increases losses to the deposit insurance fund.

Roadmap

Presentation

- I would prefer to read all the assumptions at the beginning, instead the beginning of the paper mixes the assumptions and the solution.
- The starting assumptions are probably too broad, then many more restrictive assumptions need to be added later on.
- Many variants of the model and extensions, the main point gets a bit lost in the process.

Assumptions

- Microfoundation for the depositors was a bit unclear to me.
- Microfoundation for firms shows clearly that r^L should depend on a, which changes the stochastic model a lot.
- The paper refers to banks as doing monitoring, but I don't see any in the model.
- The assumptions on the random variables of the model are very unclear at the beginning of the paper: how is a distributed, are defaults correlated or not inside a given country, across countries, etc.

Equilibrium concept

- The stochastic case is conceptually difficult, even defining an equilibrium is not trivial in this case.
- The different extensions imply a number of new problems as well. For instance without perfect correlation:
  - One unit of a MNB could survive and not the other. How does default/resolution work?
  - The two regions may not start with the same number of banks in the next period. How is this dealt with?
- Extensions should be solved extensively in dedicated appendices.

Roadmap

Conclusion

- Important point about the pro-competitive effect of MNB expansion.
- Model seems a bit complicated to make this point, but opens up a lot of interesting questions.
- I think the key contribution to make here would be to use the calibration to quantify this pro-competitive effect.
- Even better, can we also make sense of the destabilizing impact of MNBs, and quantify this one as well in the same model?

Thank you!