



Graduate School in Public Economics
University of Milan-Bicocca and Catholic University of Milan



Course on **BANKING THEORY** Prof. Xavier Freixas

Universitat Pompeu Fabra in Barcelona

October 25th – 27th

Department of Economics – Bicocca University
Seminar Room: Building U6, Third Floor, room 372

October 25th :

- 10-12 The Justification of Financial Intermediaries
- 2-4 p.m. Competition in the Banking industry
- 4.30-5.30 p.m. Exercise

October 26th :

- 9.00-11.00: Bank Runs
- 12-1.30 pm Seminar
- 3- 4 p.m. An Overall Approach to Banking Regulation
- 4.30-5.30 p.m. Exercise

October 27th :

- 9.00-10.00: Deposit Insurance
- 10.30-12.30 Closure vs. Bail-Out of Banks in Distress
- 2- 4 p.m. Information Provision and Market Discipline
- 4.30-5.30 p.m. Exercise

With the contribution of



**fondazione
cariplo**

The objective of this course is

- 1) to understand the role imperfect information and the role of financial institutions in the economy**
- 2) to explore how modeling imperfect information can lead to more accurate policy recommendations**
- 3) to discuss financial regulation as it exists and its relationship with the theory of banking.**

Textbook

Freixas, X. and Rochet, J.C., *Microeconomic theory of banking*. MIT Press, second edition. 2008 FR hereafter.

1. The justification of Financial Intermediaries

FR, pages 15-24, 30-49

References:

- Bolton, P., and X. Freixas, "Equity, Bonds and Bank Debt: Capital Structure and Financial Market Equilibrium under Asymmetric Information" *Journal of Political Economy*, April 2000, 2, 108, 324-51
- Boot A.W., Thakor A.V., "Financial System Architecture", *Review of Financial Studies*, 1997; vol.10; 3: 693-733 (BBT, 21).
- Holmstrom, B., and J. Tirole, "Financial Intermediation, Loanable Funds, and the Real Sector", *Quarterly Journal of Economics*, 1997 (BBT, 23).

2. Competition in the Banking Industry

FR, Chapter 3

References:

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- Matutes, C., and Vives X., "Imperfect Competition, Risk Taking, and Regulation in Banking", *European Economic Review*
- Ruckes. Martin "Bank Competition and Credit Standards". *The Review of Financial Studies*. Vol. 17, n° 4. 2004
- Giovanni Dell'Ariccia and Robert Marquez. "Lending Booms and Lending Standards".

3. Bank Runs

FR, pages 220-232

References:

- Chari, V., R. Jagannathan,. "Banking Panics, Information and Rational Expectations Equilibrium", *Journal of Finance*, 1988; vol. 43; 3: 749-61.
- Diamond, D. W, and R.H. Dybvig, "Bank Runs, Deposit Insurance, and Liquidity", *Journal of Political Economy*, 1983; vol. 91; 3: 401-19.
- Diamond,D.,andR.Rajan.2000."A Theoryof Bank Capital "*Journal of Finance* 55(5):24312465.
- Diamond,D.,and R. Rajan. 2001."Liquidity risk, liquidity creation and financial fragility: A theory of banking."*Journal of Political Economy* 109(2):287-327.
- Douglas W. Diamond and Raghuram G. Rajan. "A Theory of Bank Capital". *The Journal of Finance*. Vol LV. N° 6. Dec. 2000

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Jacklin, C. J., "Demand Deposits, Trading Restrictions and Risk Sharing", 1987, in *Contractual arrangements for intertemporal trade*, edited by E. Prescott and N. Wallace. Minneapolis: University of Minnesota Press.

4. An Overall Approach to Banking Regulation

FR, pages 305-312

References:

Rochet, J.C., "Capital Requirements and the Behaviour of Commercial Banks", *European Economic Review*, 1992; vol. 36; 5: 1137-70.

5. Deposit Insurance

FR, pages 313-319

References:

Morrison and White. "Is Deposit Insurance A Good Thing And, If So, Who Should Pay For It?"

Aghion, P., P. Bolton and S. Fries, "Optimal Design of Bank Bailouts: The Case of Transition Economies" JITE, p.51-70 (BBT, 14)

Bhattacharya, S., A. Boot and A. Thakor, "The Economics of Bank Regulation",

6. Closure vs. Bail-out of Banks in Distress

FR, pages 323-335

References

Dewatripont, M. and X. Freixas "Bank Resolution", Mimeo

Dewatripont, M. and J. Tirole (1994) *The Prudential Regulation of Banks*, Cambridge, MA: MIT Press.

Aghion, P., P. Bolton and S. Fries, "Optimal Design of Bank Bailouts: The Case of Transition Economies" JITE, p.51-70 (BBT, 14)

Viral V. Acharya and Tanju Yorulmazer. "Cash-in-the-Market Pricing and Optimal Resolution of Bank Failures" Review of Financial Studies

7. Information Provision and Market Discipline

FR, pages 335-38

References

Acharya, Viral V. and Tanju Yorulmazer. "Cash-in-the-Market Pricing and Optimal Resolution of Bank Failures" Mimeo Bank of England

Aghion, P., P. Bolton and S. Fries, "Optimal Design of Bank Bailouts: The Case of Transition Economies" JITE, p.51-70 (BBT, 14)

Farhi, E. and J. Tirole: "Bubbly liquidity"

Freixas, X. and C. Laux "Transparency, Disclosure, and Market Discipline"