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Does deposit insurance increase banking system stability? An empirical investigation [☆]

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Abstract

Based on evidence for 61 countries in 1980–1997, this study finds that explicit deposit insurance tends to increase the likelihood of banking crises, the more so where bank interest rates are deregulated and the institutional environment is weak. Also, the adverse impact of deposit insurance on bank stability tends to be stronger the more extensive is the coverage offered to depositors, where the scheme is funded, and where it is run by the government rather than the private sector.

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1. Introduction

The oldest system of national bank deposit insurance is the U.S. system, which was established in 1934 to prevent the extensive bank runs that contributed to the Great Depression. It was not until the Post-War period, however, that deposit insurance began to spread around the world (Table 1). The 1980s saw an acceleration

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Table 1
Deposit insurance system features

Countries	Banking crisis date	Type explicit = 1 implicit = 0	Date established	Coinsurance limit	Coverage	Foreign currency deposits covered	Interbank deposits covered	Funding Funded = 1 Unfunded = 0	Source of funding Banks only = 0 Gov. = 1 Government only = 2	Bank's premium of deposits or liabilities	Management official = 1 joint = 2 private = 3	Membership compulsory = 1 voluntary = 0
Australia		0										
Austria		1	1979	0	\$24,075 but coinsurance for businesses	0	0	0	1	Callable	3	1
Bahrain		1	1993	0		1	0	0	0	Callable	2	1
Belgium		1	1974	0	ECU 15,000, 20,000 in year 2000	0	0	1	1	0.0002 of deposits from clients	2	1
Belize		0										
Burundi		0										
Canada		1	1967	0	\$40,770	0	1	1	1	0.0033 of insured deposits (max)	1	1
Chile	1981–1987	1	1986	1	Demand deposits in full and 90% coinsurance to UJF 120 or \$3600 for saving deposits Full until 2001, then coins. 75% to \$5500 \$3557	1	0	0	2	Callable	1	1
Colombia	1982–1985	1	1985	1		0	1	1	0	0.003 insured deposits	1	1
Congo		1	1999	0		0	1	1	1	0.0015 of deposits + 0.005 of npls	2	0
Cyprus		0										
Denmark		1	1988	0	ECU 20,000	1	0	1	1	0.002 of total deposits	2	1

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