ELSEVIER Journal of Monetary Economics 46 (2000) 257–277

Journal of MONETARY ECONOMICS

www.elsevier.nl/locate/econbase

Bank runs and currency run in a system without a safety net: Argentina and the 'tequila' shock☆

Liliana Schumacher*

International Monetary Fund, 700 19th Street NW, Room 6421, Washington, DC 20431, USA

Received 3 November 1997; received in revised form 9 March 1999; accepted 27 September 1999

Abstract

This paper tests the random-withdrawals vs. informed-based theories of bank runs in the context of the bank panic that took place in Argentina as a consequence of the Mexican devaluation of December 20, 1994. This evidence is unique in several ways: it is the case of a *contemporary* banking system with virtually *no explicit safety net* (a currency board with no deposit insurance scheme) and a case in which the *bank runs were triggered by a currency run*. The findings of the paper provide support to the informed-based theories and show that depositors are concerned with the impact of a currency run on bank solvency. © 2000 Elsevier Science B.V. All rights reserved.

JEL classification: G15; G21

Keywords: Currency run; Bank runs

☆This paper is based on chapter 3 of my Ph.D. dissertation at the University of Chicago. I would like to thank my Thesis Advisors Committee – Douglas Diamond, Yair Mundlak, and Ragu Rajan – for support and advice. Special thanks also go to Mario Blejer, George Benston, Edward Kane, Gabriel Lopetegui, Anthony Saunders, and Walter Sosa for careful reading of a previous version of this paper; to Charles Calomiris, Marcelo Dabos, Roque Fernandez and Pablo Guidotti for comments and valuable suggestions; and to the Central Bank of Argentina for provision of data. Of course, all responsibilities remain mine.

* Tel.: 202-623-9416.

PII: S0304-3932(00)00022-2

1. Introduction

In recent years, banking theory and empirical research have focused on the nature of bank runs and panics. This paper studies some new evidence from a bank panic that was triggered in Argentina by the Mexican devaluation of December 20, 1994 – known as the Tequila shock – The evidence is particularly interesting because, at the time of the shock, Argentina had a banking system with virtually no explicit safety net (i.e. there was no deposit insurance and the lender of last resort had stringent limitations on providing liquidity to the system).

Two leading alternative views have emerged to explain the origins and causes of bank runs: the random withdrawals theory and the information-based theory. The random withdrawals approach, as developed in Diamond and Dybvig (1983), Waldo (1985), Postlewaite and Vives (1987), and Engineer (1989), postulates that a panic is the realization of a bad equilibrium due to the fulfillment of depositors' self-expectations concerning the behavior of other depositors. On the other hand, the information-based approach as reflected in Jacklin and Bhattacharya (1988), Chari and Jagannathan (1988), Calomiris et al. (1991), Calomiris and Gorton (1991), Jacklin (1993), and Alonso (1996), claims that a panic is an episode of market discipline during which depositors attempt to sort among ex ante 'good' (solvent) and ex ante 'bad' (insolvent) banks in a world of asymmetric information regarding bank asset values.

The importance of distinguishing between these two approaches is that each has different policy implications. If runs are due to the self-fulfillment of depositor behavior, they should be addressed mainly by providing enough liquidity to all banks. If, on the contrary, runs are caused by depositor sensitivity to the different risk exposures of banks and depositor inability to distinguish with precision the particular situation of individual banks, enhanced bank-specific information should be made available to control or to prevent runs.

Despite the importance of the theoretical debate to public policy, the empirical work on depositor run behavior is not very extensive. Empirical studies that do study depositor behavior are: Park (1991), Saunders and Wilson (1996) and Calomiris and Mason (1997). Their conclusions largely support the information-based approach to bank runs. A set of related empirical studies have examined the potential of a large bank failure to have a contagion effect on other banks by looking at bank stock returns.[1] The evidence collected in these studies generally supports bank specific, rather than industry-specific, contagion, i.e., evidence that is more compatible with then information-based approach to panics.

[1] E.g., Aharony and Swary (1983), Swary (1986), Karafiath et al. (1991), and Aharony and Swary (1996).