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How credible is a too-big-to-fail policy? International evidence from market discipline*

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Abstract

This paper analyzes in an international sample of banks from 104 countries if the sensitivity of the cost of deposits to bank risk varies across banks depending on their systemic and absolute size. We analyze a period before the 2007 financial crisis and control for endogeneity of bank size, intervention policies in past banking crises, and soundness of countries' public finances. Our results are consistent with the predominance of the too-big-to-fail hypothesis, although this effect is stronger in countries that did not impose losses on depositors in past banking crises and in countries with sounder public finances.

Keywords**:** Market discipline, too-big-to-fail, too-big-to-save, banking crisis, public deficit

JEL Classification: E43; G01; G21; G28.

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