Efficiency and stability of a financial architecture with too-interconnected-to-fail institutions

Michael Gofman

PII: S0304-405X(16)30247-1
DOI: 10.1016/j.jfineco.2016.12.009
Reference: FINEC 2729


Received date: 25 August 2015
Revised date: 17 February 2016
Accepted date: 18 March 2016


This is a PDF file of an unedited manuscript that has been accepted for publication. As a service to our customers we are providing this early version of the manuscript. The manuscript will undergo copyediting, typesetting, and review of the resulting proof before it is published in its final form. Please note that during the production process errors may be discovered which could affect the content, and all legal disclaimers that apply to the journal pertain.
Efficiency and stability of a financial architecture with too-interconnected-to-fail institutions

Michael Gofman* a

aWisconsin School of Business, University of Wisconsin - Madison, 975 University Avenue, Madison, WI 53706, United States

December 1, 2016

Abstract

The regulation of large interconnected financial institutions has become a key policy issue. To improve financial stability, regulators have proposed limiting banks’ size and interconnectedness. I estimate a network-based model of the over-the-counter interbank lending market in the US and quantify the efficiency-stability implications of this policy. Trading efficiency decreases with limits on interconnectedness because the intermediation chains become longer. While restricting the interconnectedness of banks improves stability, the effect is non-monotonic. Stability also improves with higher liquidity requirements, when banks have access to liquidity during the crisis, and when failed banks’ depositors maintain confidence in the banking system.

JEL classification: G18, G21, G28, D40, L14

Keywords: Financial regulation, Networks, Trading efficiency, Contagion risk, Federal funds market

* I am grateful to an anonymous referee and Toni Whited (the co-editor) for very detailed and insightful comments and suggestions. I thank seminar participants at University of Wisconsin-Madison, Tel Aviv University, the University of Minnesota, Ben-Gurion University of the Negev, and the Federal Reserve Bank of Cleveland, and participants at conferences organized by the Federal Reserve Bank of Chicago, Office of Financial Research, the Econometric Society, the Becker Friedman Institute, the Wisconsin School of Business and Institute for New Economic Thinking (INET), the GRETA Association, the Federal Reserve Bank of Boston, Deutsche Bundesbank, the Info-Metrics Institute, International Monetary Fund, Financial Intermediation Research Society, Midwest Finance Association, the Isaac Newton Institute for Mathematical Sciences, and University of California at Santa Cruz for their comments. This paper especially benefited from comments and suggestions by conference discussants Gara Afonso, Ana Babus, Charlie Kahn, Anand Kartik, Elizabeth Klee, Andrew Lo, and Marcella Lucchetta and from comments and suggestions by Alina Arefeva, Enghin Atalay, Thomas Chaney, Briana Chang, Hui Chen, Dean Corbae, Douglas Diamond, Steven Durlauf, Matt Elliott, Emmanuel Farhi, Lars Hansen, Matthew Jackson, Jim Johannes, Oliver Levine, James McAndrews, Christian Öpp, Jack Porter, Mark Ready, Luke Taylor, Andrew Winton, and Randy Wright. I would like to acknowledge generous financial support from INET and Centre for International Governance Innovation (CIGI) grant INO1200018, the Patrick Thiele Fellowship in Finance from the Wisconsin School of Business, travel grants from Wisconsin Alumni Research Foundation, and resources from the Center for High-Throughput Computing (CHTC) at the University of Wisconsin - Madison. I am grateful to Alexander Dentler and Scott Swisher for their research assistance and to Lauren Michael for technical support with CHTC resources. All errors are my own.

* Corresponding author. Tel.: +1 608 265 1146; fax: +1 608 265 4195.

E-mail address: michael.gofman@wisc.edu (M. Gofman).
دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات