



BULGARIAN DEPOSIT
INSURANCE FUND

Bank Failure: Market Failure vs. State Failure

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Bank Failure: Market Failure vs. State Failure

- I. What is Bank?
- II. What is Failure?
- III. Market and State.
- IV. Case Study A: Banking Crisis 1995 – 96.
- V. Case Study B: BITD Failure (2005).



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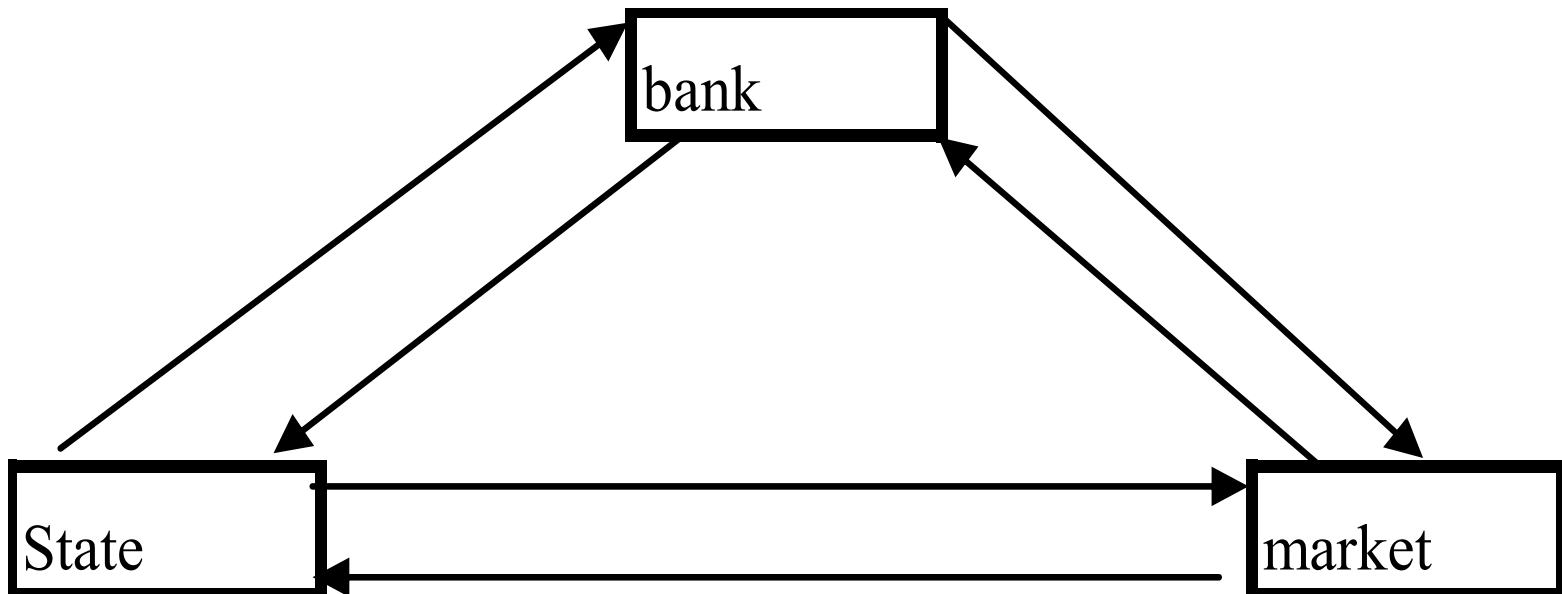
I. What is Bank?

- Bank is a special firm.
- A. What is firm? Firm (hierarchy) vs. market (chaos).
- B. What is so special with banks? assets, high leverage, opacity, insolvency social costs



I. What is Bank?

- C. Where do the borders of bank lie?
Beyond bank's borders there is nothing but market(s) and State(s).
- Decreasing identifiability of borders.





II. What is Failure?

- - dichotomy (trigger): non-failed vs. failed;
- - a life cycle of the bank;
- - stages of failure.
- answer depends on the viewpoint:
 - for a supervisor, failure \equiv insolvency;
 - for a DIF, failure \equiv insurance event;
 - for a rating agency, failure \equiv downgrades of 2-3 notches.
- potential externalities of diverging answers.



III. Market and State.

- Market's / State's comparative advantages:
- - Market vs. State \equiv Efficiency vs. Stability;
- - market is prone to fail \rightarrow justification for State regulation;
- - State takes into account the social costs of bank failure.
- Market and / or / versus State.
- costs – benefits analysis of market – State mix.
- “market discipline – regulation” mix shall match the domestic conditions, economic and social objectives.



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IV. Banking Crisis 1995 – 96.

- currency crisis → bank crisis → political crisis;
- **Market Failure:**
 - - no market economy;
 - - SOBs dominated;
 - - banking system - the major transmission channel for quasi-fiscal subsidies to SOEs;
 - - unreliable accounting standards;
 - - implicit deposit insurance of 100%;
- **State Failure:**
 - - neither prudential regulation nor supervision in place;
 - - neither political will nor legal framework to close banks down.



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V. BITD Failure (2005).

State Failure:

- **State:**
 - - joining the EU occupied too much the attention of the State;
 - - Currency Board;
 - - political wish to avoid any allusions with the 1995 – 96 crisis.
- **Bank Supervision** (not accountable for the costs of bank resolution):
 - - failed to constrain the credit boom;
 - - missed the aggressive deposit collection by BITD (moral hazard created by BDIF).
- **DIF:**
 - - pay-box;
 - - compulsory membership of the deposit insurance system;
 - - no risk-based premiums applied.
- **Safety net:**
 - - incomplete (under the Currency Board there is no LOLR);
 - - in stand-still since the 1995-96 crisis;
 - - poor communications, with no coordination.



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V. BITD Case.

State's Off-springs Failure:

- **EU:**
 - - did not allow Bulgaria to enjoy derogation on coverage level;
 - - EU legislation's financial stability pillar vs. consumer protection pillar.
- **IMF:**
 - - Currency Board vs. DIF;
 - - excessive capital account liberalization;
 - - sequence of liberalization and regulation;
- **Other:**
 - - excessive liberalization of the trade in banking services undertaken under World Trade Organization's GATS;
 - - IADI vs. BIS or IMF.



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V. BITD Case. Market Failure:

- **Missing Markets:**

- - uninsured deposits;
- - obligatory subordinated debt;
- - banking CEO.

- **Incomplete Markets:**

- - bank shareholder capital;
- - bank bond market.

- **Inefficient Markets:**

- - insured deposits (2005 survey; no co-insurance)
- - investment projects.



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- Thank you for your attention!
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