COMMENT ON

“SURVIVAL OF THE BIGGEST”

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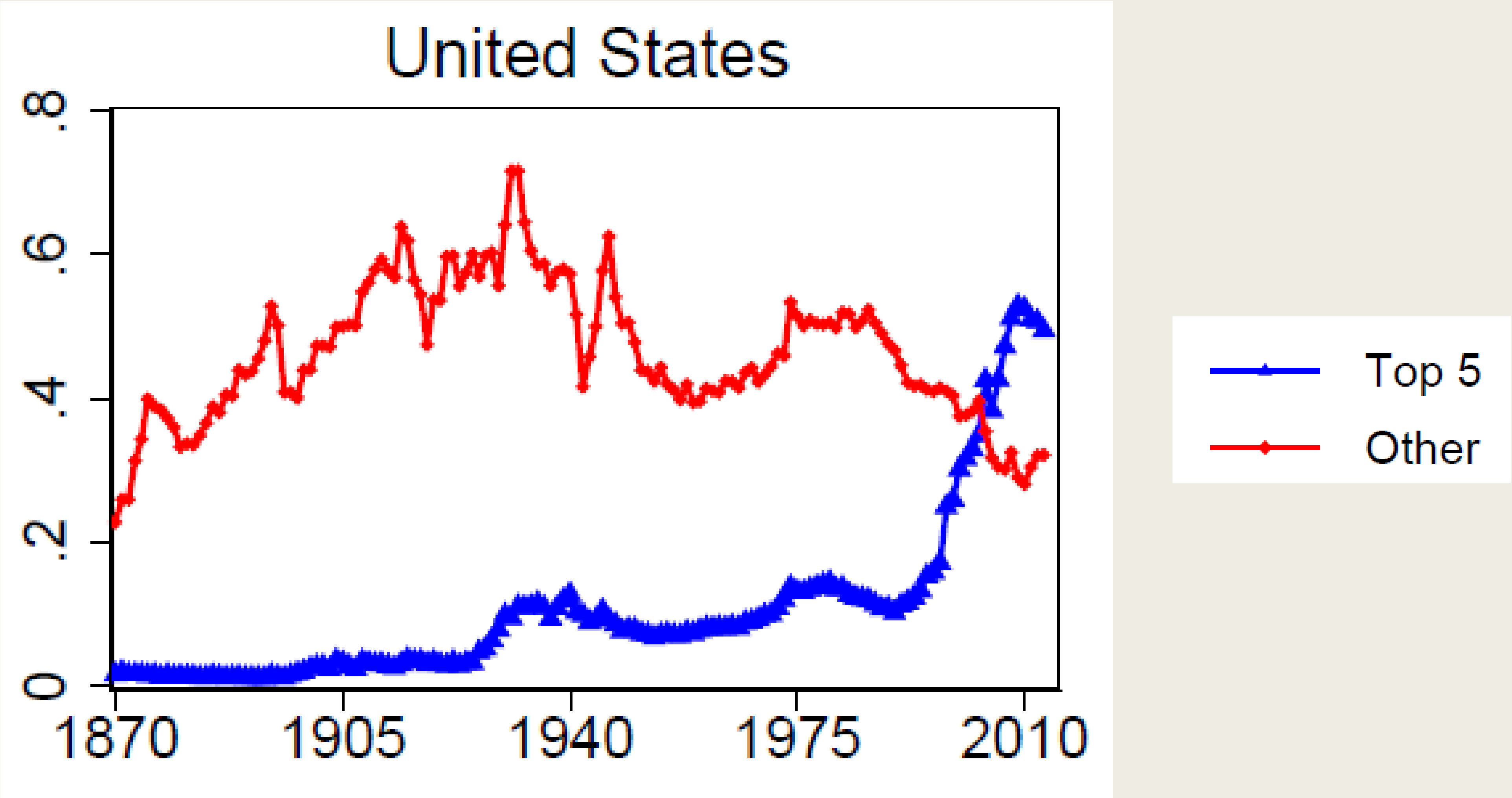
Strong Argument (p. 40):

We show that large banks account for a rising share of the aggregate financial cycle, take more risk during pre-crisis credit booms and have higher losses during the crisis. We also show that large banks grow their market shares over the boom-bust cycle due to lower failure rates and by acquiring smaller banks. Our results are consistent with theories of excessive risk taking of large banks and implicit bailout guarantees and shows that large banks have been at the epicenter of financial instability and risk taking throughout history.

Why are large banks so dominant?

- The authors consider two alternative hypotheses:
  1. *Market forces, such as economies of scale or advantages in crises*
  2. *Government policy, such as bailouts of large but not small banks*
- Claim evidence supports the second. Find:
  – *"[L]arge banks typically take more, not less, risk than smaller banks in the run-up to crises, and … suffer bigger equity losses and contract their lending more in the aftermath of crises" (2).*
  – *Yet large banks' market share tends to grow in crises, in part because they are more resilient but also because of the way governments reorganize the banking sector in the aftermath of crises.*
- As a matter of logic, the authors' findings can be true and the first hypothesis can also be true.

Ratio of Bank Assets to GDP



What is a banking crisis?

- The authors define banking crises as “country-year observations that are the first years of aggregate credit crunches”—that is, “the past three-year change in the ratio of bank credit-to-GDP is less than -1 s.d. relative to that country’s history” (11).
- They reject previous chronologies of bank crises to avoid bias because the chronologies “are more likely to call an episode a banking crisis if it involves distress of one or several of the largest banks in a country” (11).
- But worry that their definition is also biased. Given the extent of concentration in the banking sector, it’s difficult to conceive of a credit crunch of that magnitude without massive involvement of the largest banks.

Table 2—New Series on Banking Panics, 1825–1929

Major banking panic	Nonmajor banking panic
Nov. 1833–Apr. 1834	
Mar.–May 1837	
Oct. 1839	
	Jan.–April 1841 (Pennsylvania, Delaware, Maryland, North Carolina, Virginia, Illinois)
	March 1842 (Pennsylvania)
	May–June 1842 (New Orleans)
	Oct. 1851 (New York, New Jersey, Maryland)
	Sept. 1854–Feb. 1855 (Ohio, Indiana, Michigan, Wisconsin, Iowa, Missouri, New York, California)
Aug.–Oct. 1857	
	Nov. 1860 (suspension of specie payments by banks in the South)
	Dec. 1861 (generalized suspension of specie payments)
Sep. 1873	
	May 1884 (New York City, Pennsylvania, New Jersey)
	Nov. 1890 (New York City)
May–Aug. 1893	
	Dec. 1896 (Illinois, Minnesota, Wisconsin)
	Dec. 1899 (Boston and New York City)
	June–July 1901 (New York: Buffalo and New York City)
	Oct. 1903 (Pennsylvania, Maryland)
	Dec. 1905 (Chicago)
Oct.–Nov. 1907	
	Jan. 1908 (New York City)
	Aug.–Sept. 1920 (Boston)
	Nov. 1920–Feb. 1921 (North Dakota)
	July 1926 (Florida, Georgia)
	March 1927 (Florida)
	Jul.–Aug. 1929 (Florida)

Source: Andrew J. Jalil, "A New History of Banking Panics in the United States, 1825-1929: Construction and Implications," *AEJ: Macroeconomics* 7 (July 2015): 295-330 at 305

BSZ Year of Credit Boom Peak Before Credit Crunch in US

1875
1892
1920
1930
1989
2007

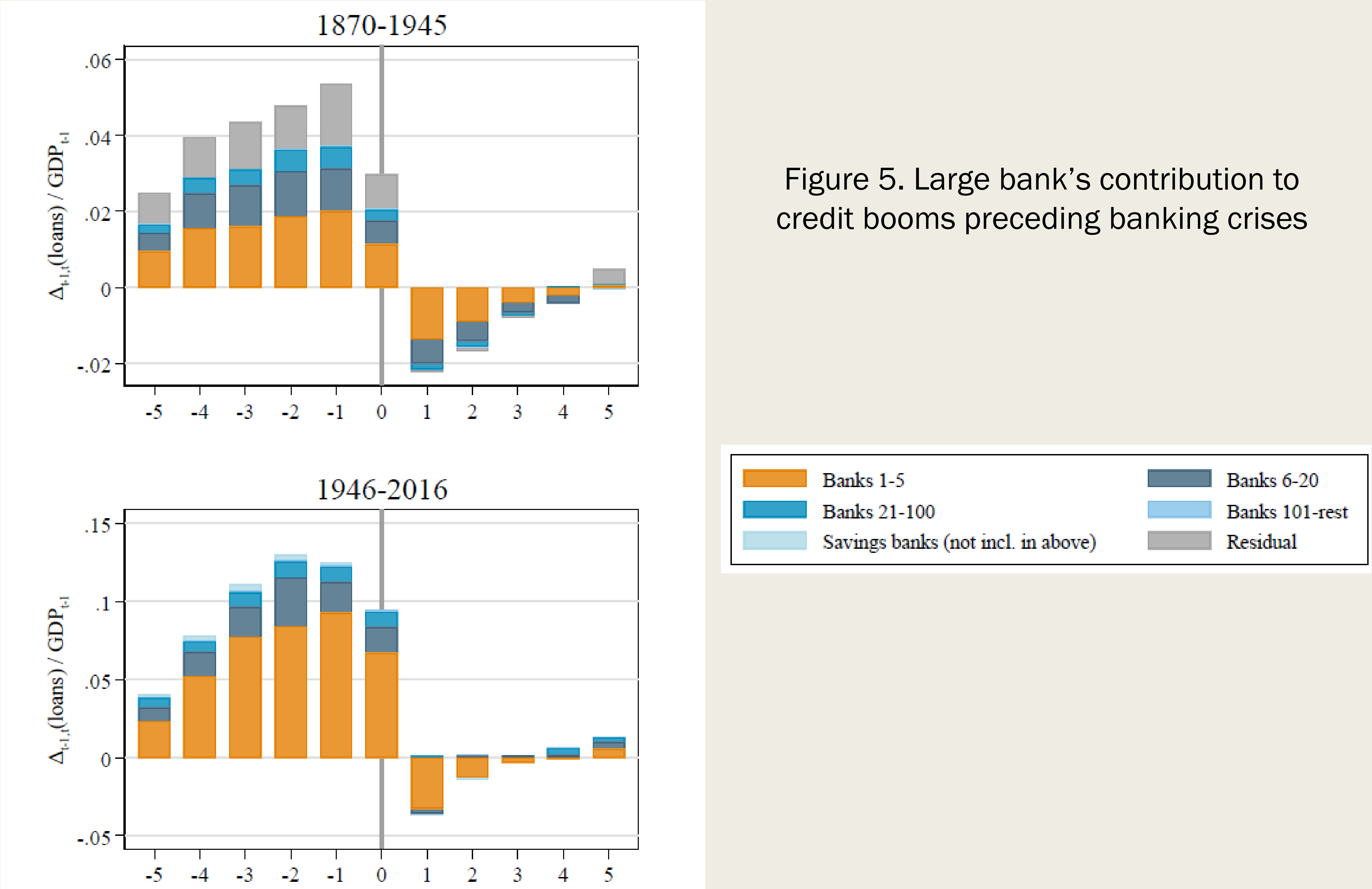


Figure 5. Large bank’s contribution to credit booms preceding banking crises

CINCINNATI CHECKS SMALL BANK RUNS

Four There, Linked With Suspended National Bank of Kentucky, Bought Up.

CHEMICAL SUES ON ITS LOAN

Eleven Arkansas Closings Put Total in State at 54 — Caldwell Receivers Active.

NASHVILLE BANK SUSTAINS LONG RUN

Hermitage Institution Pays Out Money All Day, With Officials Confident.

KNOXVILLE MERGER HELPS

Fiscal Agents Here of Tennessee Offer Loan of $5,000,000 to the State.

CALDWELL & CO. PUT INTO RECEIVERSHIP

Lee Douglas Named by Federal Court to Take Charge of Banking House's Assets.

ANOTHER BANK IS CLOSED

Business at Knoxville Again Nearly Normal and the Banking Public is Calmer.

Contagion sparked by collapse of Caldwell & Co. in early November, 1930.

Failure of the Bank of United States in New York, December 11, 1930

Chronology of the Savings & Loan Crisis:

- More than 1000 S&Ls collapsed in late 1980s—cost the Federal government more than $100 billion—doesn't include cost to states.
- Some highlights
  - *1985 Home State Savings Bank collapsed in Ohio—led to runs that drained the state's insurance fund and the closure of many S&Ls in the state (failure of Old Court Savings and Loan in Maryland had similar effect)*
  - *1987 FSLIC deemed insolvent—Congress recapitalized it.*
  - *1988 Peak year for failures (spread outward from epicenter in Texas)*
  - *1988 Silverado Savings and Loan collapsed in Colorado—cost the federal government $1.3 billion*
  - *1989 Lincoln Savings and Loan collapsed in California—cost federal government $3.4 billion*
- 1989 Congress passes the Financial Institutions Reform, Recovery and Enforcement Act
  - *abolished FSLIC (moved the sector to FDIC)*
  - *abolished the Federal Home Bank Board and created the Office of Thrift Supervision*
  - *Set up Resolution Trust Corporation to handle troubled S&Ls*