

## Regulation of the financial sector – economic consequences, costs and benefits

Insights from the 2<sup>nd</sup> SUERF/UniCredit & Universities Foundation  
Workshop held in Vienna on  
11 December, 2014



*Josef Zechner, Christian Laux, Elena Mattana, Roberto Robatto, Ernest Gnan, Franco Bruni, Annalisa Aleati, Ettore Panetti*

### By Ernest Gnan, Secretary General, SUERF

On Thursday 11 December 2014, on the occasion of the award of the 2<sup>nd</sup> SUERF/UniCredit & Universities Foundation Research Prize, a half-day workshop on the topic of “**Regulation of the Financial Sector – Economic Consequences, Cost and Benefits**” took place at the Vienna University of Economics and Business.

The workshop, which gathered around 30 academics and PhD students, was opened by **Josef Zechner**, Professor, Vienna University of Economics and Business, and by Ernest Gnan, Secretary General, SUERF. Both speakers respectively recalled the missions and activities of the UniCredit & Universities Foundation and of SUERF, which fit together very well. They expressed their satisfaction with the fruitful collaboration in the context of this prize, which has been awarded for the second year running. A third edition for next year is certainly envisaged. They emphasised the importance and topicality of the call for papers and praised the quality of submissions. The two winning papers were selected among 30 submissions by authors from 14 nations and affiliated with 30 different institutions, with the youngest author aged 24 and the oldest 34.

In the main session, chaired by **Christian Laux**, Professor, Vienna University of Economics and Business, the authors presented their prize-winning papers.

First, **Ettore Panetti**, Banco de Portugal, Research Department, presented his paper, co-authored with Elena Mattana, Université catholique de Louvain-CORE, on “**A Dynamic Quantitative Macroeconomic Model of Bank Runs**”. The paper studies the macroeconomic effects of bank runs in a neo-classical model with a micro-founded banking sector. Among the many findings, the paper shows that banks, when the probability of a run is sufficiently low, choose a contract that is not run-proof. Contrary to other literature, the authors calibrate the probability of a liquidity shock, rather than arbitrarily assuming it. A shock to the probability of a bank run leads to credit tightening, followed by any initial loss and subsequent recovery of GDP, which is in line with practical experience. Though estimated conservatively, the macroeconomic effects of bank-runs are shown to be very substantial. The paper also shows that, in terms of the servicing of depositors’ claims against banks in a bank run, equal service of all



*Ettore Panetti*

depositors is clearly to be preferred over a first-come-first-serve approach, since it is associated with a faster post-run economic recovery and lower welfare costs. Furthermore, the paper shows that ruling out bank runs altogether through macroprudential policies can be costly, both in terms of distortions of resource allocation and intertemporal welfare, so it should be implemented only in case of a sufficiently high probability of runs. Finally, the paper offers an interesting starting point for future research in various directions, including effects of moral hazard, adverse selection and asymmetric information. The model could also be extended to study interactions of the banking sector with the labour market, with business cycle fluctuations and with monetary policy.

The second paper presented by **Roberto Robatto**, University of Wisconsin-Madison, dealt with “**Financial Crises and Systemic Bank Runs in a Dynamic Model of Banking**”. It asks the question of what are the effects of unconventional monetary measures during panic-driven financial crises. To study this question, the author employs a dynamic general equilibrium model which allows for multiple equilibria. In the bad equilibrium many banks become insolvent and experience runs,



*Roberto Robatto*

savers react with a flight to liquidity and the economy suffers from deflation. The paper then experiments with two types of monetary policy: bank loans and asset purchases. While both policies counteract deflation and reduce banks’ losses, the paper also shows that for some parameter values both policies in fact amplify the flight to liquidity; and that the central bank’s asset purchases preclude a crisis only if the central bank is committed to creating inflation in the event of a panic.

Both papers triggered a vivid discussion during and after the presentation, which generated a panoply of ideas for further refinements and extensions of the models and for new research projects.

The workshop concluded with topical remarks by **Franco Bruni**, Chairman of the Scientific Committee, UniCredit & Universities Foundation and former SUERF President, who also presented the winners with their awards.

The papers and presentations are available for download on the SUERF Website at [www.suerf.org/vienna-uuf2014](http://www.suerf.org/vienna-uuf2014).