

Written Exam at the Department of Economics summer 2026

Economics of Banking

Re-Exam

19.8.2026

(3-hour written no aids allowed)

Answers only in English.

This exam question consists of 2 pages in total

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- Or if you otherwise violate the rules that apply to the exam

1. A country has a financial sector where a few large banks dominate the market for financial services. Traditionally the banks keep very small liquid reserves covering only the ordinary daily withdrawals by depositors, so that other liquidity needs are covered by credits with other banks or with the central bank.

To make banks hold a larger cash reserve the government introduces a tax on the short term interbank loans and raises the interest rate to be paid to the central bank. It is argued that this will make it more attractive for the banks to hold larger reserves, and that the changes in the cost structure of the banks will induce more competition and give rise to a general reduction in loan rates.

Give an assessment of this argumentation using the theory of competition and risk taking of banks.

2. In a situation where a considerable number of small and medium-sized banks have had liquidity problems, often caused by losses on their credits, it is proposed to initiate a procedure of merging the banks into a few much larger units. Give a discussion of whether this will improve the stability of the financial sector and whether it will have unintended side effects.

As an alternative to this concentration of the banking sector, it is suggested that each bank should hold a fixed percentage of its assets in the form of equity of the other banks. Give an assessment of this alternative proposal: Does it reduce instability and what will be the effect on the competition in the banking sector?

3. As a consequence of the general political situation, many small entrepreneurs are interested in developing new types of military drones to be sold to the ministry of defence. The typical developer may have some initial capital but will nevertheless need additional credits for setting up production. For each firm it is uncertain at the outset whether its particular production will be accepted by the ministry, but the probability of success can be predicted reasonably well.

It is argued that the banking sector, which usually supplies credits to developers, is inefficient in the sense that it prevents profitable activities to be initiated. Give a theory-based assessment.

After a long debate on this issue, it is decided to create a specialized non-for-profit institution to provide credits tailor-made for the sector. How should the loan contracts be set up?