

Written Exam at the Department of Economics summer 2023

## **Economics of Banking**

ReExam

22.8.2023

(3-hour closed book exam)

Answers only in English.

**This exam question consists of 2 pages in total**

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- submit a blank exam paper.
- leave the examination.
- contact your GP and submit a medical report to the Faculty of Social Sciences no later than five (5) days from the date of the exam.

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You cheat at an exam, if during the exam, you:

- Make use of exam aids that are not allowed
- Communicate with or otherwise receive help from other people
- Copy other people's texts without making use of quotation marks and source referencing, so that it may appear to be your own text
- Use the ideas or thoughts of others without making use of source referencing, so it may appear to be your own idea or your thoughts
- Or if you otherwise violate the rules that apply to the exam

1. A new export oriented industry is characterized by many small entrepreneurs with limited capital of their own, depending heavily on bank credits.

The business plans of the entrepreneurs wanting to establish themselves in the industry are all alike: Production is aimed for export, and a considerable profit can be obtained if the entrepreneur finds the right middleman in the foreign country, otherwise the production will be close to unsaleable. The ability to find suitable business partners may vary from one entrepreneur to another.

The sector is complaining that it has very limited access to affordable credits. Give a brief sketch of a theoretical model which can be used to assess whether these complaints are justified.

Which type of regulation should be used if the particular credit market is not functioning in an optimal way.

2. In a particular sector of the economy, the enterprises are either engaged in export to emerging markets or alternatively directing its activities towards the home market. Business credits have traditionally been given against collateral in the form of real estate mortgage deposited with the bank. The credit market has been at equilibrium for some time.

Give a short description of the equilibrium and explain the differences in the contracts for the two types of borrowers.

As a result of new legislation as well as increased uncertainty in the real estate market, the value of collateral to the bank decreases, and the cost to the borrower of pledging collateral increases. In this new situation, the enterprises ask for government support with two different lines of argumentation, namely (1) that the export industry of the country is particularly severely affected, and (2) that the traditionally stable credit market is in danger of a major breakdown.

Give an assessment of these two lines of argumentation.

3. During a period of financial instability, several banks had to be closed and their depositors reimbursed by the system of deposit insurance. Several of the small banks defaulted as a result of bankruptcies in the housing construction market which suffered particularly during the crisis. It is therefore proposed that the insurance premium paid by the banks should depend on their deposits in a degressive way, constituting a larger fraction for small than for large banks.

Comment on this arrangement from a theoretical point of view. Does it address the problem which was evidenced in the recent crisis?

In the period of recovery after the crises, mergers and acquisitions in the banking sector have reduced the number of banks, so that only a few banks remain, each of them very large. What are the implications for the new system of payment for deposit insurance?