Bank Competition and Risk-Taking under Market Integration

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Increased bank competition from market integration affects banks' risk-taking behavior in ways beyond a simple increase in the number of competitor banks.

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Linkages between bank competition and stability are analyzed in a generalized theoretical framework where market integration is the principal driver of increased competition. Risk implications of across-market competition under banking market integration are significantly different from that of within-market competition. While both modes of analyzing competition increase the number of competitor banks, any relation between competition and risk-taking under within-market competition can be shown to reverse with across-market competition under market integration. Robust to different settings, this result suggests that the lack of consensus in the bank competition-financial stability literature is not an anomaly but an inherent feature of the problem.

JEL Classification: D82, G21, L13

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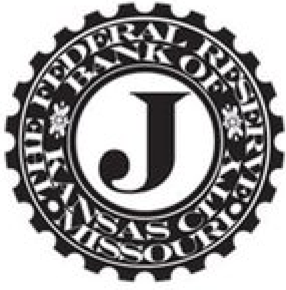

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