

BOSTON COLLEGE
DEPARTMENT OF ECONOMICS

EC 369
Spring 2000
MW 3 p.m.
Carney 105

Joe Peek
Office: Carney 141, 2-3686
Office Hours: M 4:30-5:30 p.m.,
W 10:30-11:30 a.m. & 4:30-
5:30 p.m., and by appointment

International Banking

Texts: Roy C. Smith and Ingo Walter, *Global Banking*, Oxford University Press, 1997; Richard J. Herring and Robert E. Litan, *Financial Regulation in the Global Economy*, The Brookings Institution, 1995 (both available at the BC bookstore).

In addition to the set of articles included in the course outline, I will hand out in class numerous short articles from current newspapers and magazines that are particularly relevant to the topic being discussed. All assignments are to be read before the class during which they will be discussed.

This course applies the standard tools of financial analysis and economics to issues in the operation and regulation of internationally active financial intermediaries. The primary focus will be on commercial banks, although other intermediaries will be discussed. The course will address the activities of internationally active banks and the risks that they face. Emphasis will be placed on the continuing innovation and evolution of financial markets and financial institutions and on their interaction with the changing regulatory environment.

This course is designated as one of the department's courses with a significant writing/research component. Much of the value-added of the course, as well as a significant portion of your course grade, will be associated with the two major written assignments.

Method of Evaluation: The course has three major components. The first is based on course lectures and assigned readings. The second is based on an individual case study of an internationally active banking organization. The third is based on a group project. The lecture component will have one exam at the end of the lecture portion of the course, tentatively scheduled for Wednesday, April 12. The case study will be due on Monday, April 3. The group project component will continue throughout the semester, culminating in a presentation to the class. The presentations will occur during the meetings at the end of the course, following the exam. Course grades will be calculated using the following weights: exam 40%; case study 30%; project 20%; class participation/presentation 10%.

OUTLINE

- I. Introduction
 - Smith & Walter, Ch. 1.
 - Herring & Litan, Ch. 1.

 - Herring & Litan, Ch. 2.
 - Richard M. Levich, *International Financial Markets*, Ch. 5.

- II. Why Should We Care About International Banking?
 - Ross Levine and Sara Zervos, "Stock Markets, Banks, and Economic Growth," *The American Economic Review*, June 1998, pp. 537-558.
 - Raghuram G. Rajan and Luigi Zingales, "Financial Dependence and Growth," *The American Economic Review*, June 1998, pp. 559-586.

- III. Overview
 - Asli Demirguc-Kunt and Ross Levine, "Bank-Based and Market-Based Financial Systems: Cross-Country Comparisons," Working Paper No. 2143, downloadable from World Bank Web site
 - James R. Barth, Gerald Caprio, Jr., and Ross Levine, "Banking Systems Around the Globe: Do Regulation and Ownership Affect Performance and Stability?," presented at NBER Conference on Prudential Supervision: What Works and What Doesn't, available for download at www.nber.org/books/mishkin/index.html.

- IV. International Commercial Lending
 - Smith & Walter, Chs. 2-3.

- V. Retail and Private Banking
 - Smith & Walter, Ch. 4.

- VI. Cross-Border Risks
 - Smith & Walter, Ch. 5.

- VII. International Bank Regulation
 - Smith & Walter, Ch. 6.
 - Herring & Litan, Chs. 3-5.
 - Charles W. Calomiris and Andrew Powell, "Can Emerging Market Bank Regulators Establish Credible Discipline? The Case of Argentina, 1992-1999," presented at NBER Conference on Prudential Supervision: What Works and What Doesn't, available for download at www.nber.org/books/mishkin/index.html.

- VIII. Structural Change in Global Financial Flows
 - Smith & Walter, Ch. 7.

- IX. International Capital Markets
 - Smith & Walter, Chs. 8-11.

- X. Alternative Banking Systems
 - Chs. 3-4 in Franklin Allen and Douglas Gale, *Comparing Financial Systems*, The MIT Press, 2000.
 - Raghuram G. Rajan and Luigi Zingales, "Which Capitalism? Lessons from the East Asian Crisis," *Journal of Applied Corporate Finance*, Fall 1998, pp. 40-48.

- XI. International Transmission of Shocks Through Internationally Active Banks
 Joe Peek and Eric Rosengren, "Collateral Damage: Effects of the Japanese Bank Crisis on Real Activity in the United States," *The American Economic Review*, March 2000, forthcoming.
 Michael Klein, Joe Peek, and Eric Rosengren, "Troubled Banks, Impaired Investment: The Case of Japanese FDI," working paper, November 1999.
- XII. Lessons from Recent Banking Crises
 Gerard Caprio, Jr., "Banking on Crises: Expensive Lessons from Recent Financial Crises," Working Paper No. 1979, downloadable from World Bank Web site
 Steven Radelet and Jeffrey Sachs, "The East Asian Financial Crisis: Diagnosis, Remedies, and Prospects," *Brookings Papers on Economic Activity*, No. 1, 1998, pp.1-90.
 Jason Furman and Joseph E. Stiglitz, "Economic Crises: Evidence and Insights from East Asia," *Brookings Papers on Economic Activity*, No. 2, 1998, pp.1-135.
 Frederic S. Mishkin, "Global Financial Instability: Framework, Events, Issues," *The Journal of Economic Perspectives*, Fall 1999, pp. 3-20.
 Kenneth Rogoff, "International Institutions for Reducing Global Financial Instability," *The Journal of Economic Perspectives*, Fall 1999, pp. 21-42.
 Gerard Caprio and Patrick Honohan, "Restoring Banking Stability: Beyond Supervised Capital Requirements," *The Journal of Economic Perspectives*, Fall 1999, pp. 43-64.
 Sebastian Edwards, "How Effective Are Capital Controls?," *The Journal of Economic Perspectives*, Fall 1999, pp. 65-84.
 Stanley Fischer, "On the Need for an International Lender of Last Resort," *The Journal of Economic Perspectives*, Fall 1999, pp. 85-104.

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Case Study

Each student will select an internationally active banking organization (a bank or bank holding company, depending on the structure of the organization); no duplications, first come, first served. The banking organization (bank) may be headquartered in any country. The assignment involves doing a case study on the selected bank. The study should provide a brief history of the bank's international operations and how those operations fit into the overall structure of the bank. You should discuss the bank's current structure (number and types of subsidiaries), primary lines of business, and its business strategy, in each case with an emphasis on how the international operations component of the bank is related to its domestic operations. You should then provide a more detailed case study on the bank's foreign operations that includes the structure, locations, and activities of its foreign operations, as well as the competitive state of the markets where it operates and the contribution of foreign operations to the profitability and risk exposure of the banking organization. In addition, you should make an evaluation of the bank's strategy for its foreign operations and assess its competitive future in the foreign markets in which it operates.

Useful Sources

Smith and Walter; Herring and Litan

Beck, Demirguc-Kunt, and Levine, "A New Database on Financial Development and Structure," Working paper No. 2146, downloadable from World Bank Web site.

bank's home page and annual reports

Central Bank or Bank Supervisory Agency in countries where bank operates

fedweb.frb.gov/internet/bdlinks.htm#webpd has links to many foreign central banks

www.ecb.int European Central Bank

www.worldbank.org/html/dec/Publications/Workpapers/domfincapmks.html

www.imf.org/external/pubind.htm

www.bis.org/publ/index.htm

www.fdic.gov (if U.S. bank)

www.ots.treas.gov (if U.S. bank)

<http://lamar.colostate.edu/~rphillip> has a lot of useful internet links

http://www.frbchi.org/rcr/rcr_database.html (if U.S. bank)

Moody's, Standard and Poor's, Value Line, and other analysts' reports

Due date and page limit

The case study is due (on or before) Monday, **April 3**.

The page limit is **8 pages**, double spaced with 12 point font and 1 inch margins. You may include additional tables or figures only to the extent that they are discussed in the text.

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Group Project/Paper Guidelines

Project groups will consist of 3 or 4 students. I am willing to let you select your groups, but am also willing to randomly assign students into groups. The method of group formation will be decided at the first class meeting.

Self Evaluation

Adverse selection, moral hazard, and the free-rider problem are among the more important issues in banking and finance. First-hand experience, that is, learning by doing, is a very effective way for a person to learn, but an even more effective way to ensure that what is learned is remembered. The group project will provide relevant experience for that time in your life when you leave college and enter the "real world." You may often be involved in group projects in your work environment that expose you to these risks. To help address these issues, each student will provide a confidential evaluation of the relative (percentage) contributions of each member of his/her group to the group's project. This **may** be a factor in the overall grades for the project.

Topic and Schedule

This semester's topic will be **Latin American Banking Markets**. Each group will be responsible for selecting a country, but I must approve your selection (Argentina is not available). Each group will make a presentation of their research to the class and respond to questions. The presentations will be in the second half of the course. The paper should be well-organized and focused on the issues. Adding extra pages of material not on point will be viewed as a negative contribution. The page limit is **25 pages**, double spaced with 12 point font and 1 inch margins. You may include additional tables or figures only to the extent that they are discussed in the text.

The schedule for the project is as follows:

Jan. 26 (W)	Submit country selection and list of group members
Feb. 23 (W)	Submit detailed outline and data sources/availability
Ap. 10 (M)	Submit first draft of paper
Ap. 19-May 1	Presentations (dates approximate)
May 5 (F)	Submit final draft of paper
May 5 (F)	Submit self evaluation of group

All due dates should be read as "No later than...." You can, of course, complete any and all tasks (other than the presentation) prior to the recorded due date.

The key word for the paper/project is analyze. A literature review (summary) or historical description alone is not sufficient. I expect a research paper that makes use of economic and finance arguments and analysis, makes use of data, and includes a bibliography.

The Problem

An internationally active U.S. bank is considering expanding its operations by entering a specific (the one you have chosen) Latin American country. You are not to give a specific identity to the bank, but obviously it cannot be a U.S. bank already operating in the chosen country. This bank has asked for an analysis of the banking market in the country to help it devise an appropriate strategy for entering the market and then expanding operations there.

The Approach

You should approach this project as members of a consulting firm asked by an internationally active bank to analyze the banking market in a particular Latin American country. You should include analyses of the structure of the banking market, the competitive situation (both domestic and foreign competitors), bank regulation and supervision in the country, and any restrictions on the entry or operations of foreign banks. You should not restrict your analysis to retail banking, since foreign banks often are involved in other lines of business in foreign countries, such as wholesale banking, private banking, custodial services, trust activity, administering pension funds, etc. Your paper should also address issues such as political and foreign exchange rate risks.

Information Sources

There are many sources that will provide useful information for your project. Certainly, *The Wall Street Journal*, the *Financial Times*, and *The Economist* have had numerous articles on banking issues and banking firms in various Latin American countries. In fact, the *Financial Times* has special sections on individual countries that appear periodically. The Bank for International Settlements (BIS), The World Bank, The International Monetary Fund (IMF), and possibly the Organization for Economic Cooperation and Development (OECD) have publications and working papers that will be quite relevant. Useful material can be found on their WEB sites, including downloadable policy studies and research working papers. (The case study description provides the WEB sites.) You may also be able to find useful information on the WEB site of the country's Central Bank or Bank Supervisory Agency. The BC library subscribes to numerous economic and finance journals and trade publications. The economic reviews of the various regional Federal Reserve Banks often have relevant articles, as do the proceedings of the annual FRB Chicago bank structure conference. Additional bibliographic sources include the *Business Periodicals Index*, the American Bankers Association *Banking Literature Index*, the *American Banker Index*, the *Wall Street Journal Index*, and the *Journal of Economic Literature*. *The Fed in Print*, distributed by the FRB of Philadelphia and available on the WEB, lists articles and working papers produced within the Federal Reserve System.

Also, the following article may be useful:

Claessens, Demirguc-Kunt, and Huizinga, "How Does Foreign Entry Affect the Domestic Banking Market?," Working Paper No. 1918, downloadable from World Bank Web site.

Finally, once you select your country, I may be able to help get you started with a few relevant articles or data sources.