

ABSTRACT

Collective action problems are likely to arise in concerted lending situations. The sources of lending structures which hinder collective actions are therefore of policy concern. This paper introduces a monopolistically-competitive model in which risk-averse banks choose a level of concentration ex-ante which hinders their collective action ex-post. Decreases in loan concentration result in an increase in the degree of credit contraction in bad states, an increase in the probability of default, and an increase in the expected burden on FDIC funds.

Both explicit and implicit deposit insurance act to increase further the number of banks participating in lending. Explicit deposit insurance both subsidizes risky loans and diminishes private sources of market regulation of lending structure. FDIC intervention into system-threatening situations, in which uninsured deposits of failing banks are carried at par subsequent to a merger, provides an additional "implicit deposit insurance." This policy provides additional incentives for a decrease in the level of concentration in lending, as banks attempt to increase the perceived systemic nature of a loan.