

U.S. Commercial Banking: Trends, Cycles, and Policy\*

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This paper pinpoints sources of recent problems in U.S. commercial banking. The objective is to provide a context for evaluating policy options. There are three parts. The first documents how increased competition and financial innovation made banking less stable in the 1980s. The second part identifies the specific sources of the industry's difficulties over this decade. We find that the poor ex post performance by large banks provided the main stress on the system. From a variety of evidence, we conclude that this poor performance was the product of increased competition for the industry and a regulatory system that provides greater subsidies to risk-taking by large banks relative to the industry mean. The third part analyzes recent policy reforms and on-going policy options, in the light of our evidence on the main sources of problems in banking.