Deposit Insurance

Insurance systems for bank deposits have made a remarkable development since the 1960s. While in 1960 only three countries had introduced an explicit deposit insurance system, today the number amounts to 75. An especially dynamic development occurred during the 1980s and 1990s, when the number of deposit insurance countries increased by 21 and 30, respectively (Figure).

Deposit insurance is in many countries an important corner stone of a safety net for the national financial system. And it is not astonishing that the financial crises of the 1980s and 1990s led many countries to update their financial safety net, also by adopting deposit insurance.

The costs of a large-scale ("systemic") financial and banking crisis are multi-faceted and can be enormous. The costs have to be borne by depositors, good borrowers, prudent banks, potential issuers of debt and equity instruments, as well as by the taxpayers. But it is not only these fiscal costs. The society as a whole suffers in the form of halted growth and development programmes, and increased poverty. Fiscal costs have been estimated to be approximately 30 percent of GDP for the financial crises of Thailand and South Korea in 1997, while for Indonesia the budgetary costs alone might have even approached 50 percent of GDP.

Deposit insurance – together with other forms of a financial safety net, like bank regulation and supervision, bank insolvency resolution procedures and lending of last resort of the central bank – is plausibly seen as contributing to avoiding the costs of financial crises. However, it would be erroneous to believe that deposit insurance comes without costs: Depositors face fewer incentives to monitor their banks, and banks might feel tempted to engage in excessive risk-taking. Explicit deposit insurance might, thus, lead banks to incur higher instead of lower risks. Moreover, the development of the national capital market, specifically the equity market, might be negatively influenced by deposit insurance systems.

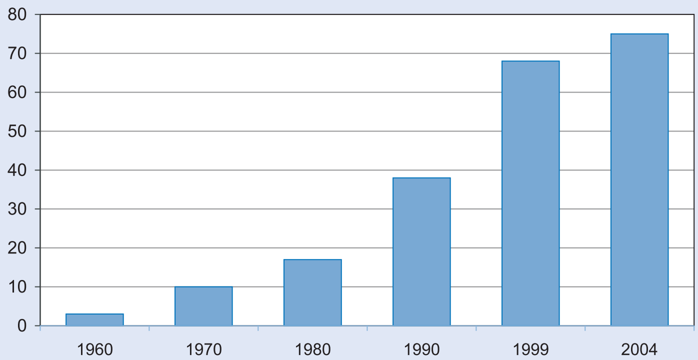
The latter argument is empirically substantiated by a recent analysis (Cecchetti and Krause 2004) which shows that countries with explicit deposit insurance and a high degree of state-owned banks (implicit insurance) have smaller equity markets, a lower number of publicly traded firms and a lower amount of bank credit to the private sector.

The trade-off between potential systemic crises due to no safety net (e.g. no deposit insurance) and the negative effects of moral hazard for banks and depositors due to deposit insurance (i.e. low market discipline) is unavoidable. But more or less favourable compromises might be possible. A good compromise seems to depend crucially on the details of the design of the deposit insurance. The Table, concentrating on European countries, presents some of the relevant design details. The whole informational base, resulting from a World Bank research initiative on deposit insurance, is much larger, containing more variables and more countries (for the source, see Table).

In their empirical study using the data base, Demirgüc-Kunt and Huizinga (2004) have found that high explicit and broad insurance coverage, government provision of funds and public management of deposit insurance lead to lower required deposit rates for attracting funds and to reduced market discipline.

R. O.

Number of Countries with Explicit Deposit Insurance Systems 1960–2004



Source: Demirgüc-Kunt and Kane (2001); www.worldbank.org/research/projects/bank_regulation.htm

References

Cecchetti, St. G. and St. Krause (2004), "Deposit Insurance and External Finance", *NBER Working Paper* no. 10908.

Demirgüc-Kunt, A. and H. Huizinga (2004), "Market Discipline and Deposit Insurance", *Journal of Monetary Economics* 51, 375–399.

Demirgüc-Kunt, A. and E. J. Kane (2001), "Deposit Insurance Around the Globe: Where Does it Work?", *NBER Working Paper* no. 8493.

Deposit insurance in Europe: Characteristics of explicit deposit insurance

Country	Date established	Coverage limit	Foreign currency deposits covered	Interbank deposits covered	Annual insurance premiums	Management	Membership
Austria	1979	260,000 ATS	yes	no	Callable	private	compulsory
Belgium	1985	15,000 ECU	no	no	0.0002 of deposits from clients	joint	compulsory
Denmark	1988	300,000 DKR	yes	no	0.002 of insured deposits, max.	joint	compulsory
Finland	1969	150,00 FIM	yes	no	0.0005-0.0030 of insured deposits	private	compulsory
France	1980	400,00 Fr	yes	no	Callable	private	compulsory
Germany	1966/1998	Private: 30% of capital; official co-insurance: 90% to 20,000 ECU	yes	yes	Official is 0.03, but can be doubled	private	compulsory
Greece	1995	20,000 ECU	yes	no	0.00025-0.0125 of eligible deposits	joint	compulsory
Hungary	1993	1,000,000 Ft	yes	no	0.003 of insured deposits, max.	public	compulsory
Ireland	1989	90% of 20,000 ECU	yes	no	0.002 of insured deposits	public	compulsory
Italy	1987	100% of first 200 Mil. ITL	no	n.a.	0.004-0.008 of insured deposits	private	voluntary
Luxembourg	1989	15,000 ECU	yes	no	Callable	private	compulsory
Netherlands	1979	20,000 ECU	yes	no	Callable	public	compulsory
Spain	1977	15,000 ECU	yes	no	0.0002 of deposits, max.	joint	compulsory
Sweden	1996	250,000 SEK	yes	no	0.005 of deposits and 0.001 callable	public	compulsory
United Kingdom	1982	75% of 20,000 GBP	yes	no	Callable	private	compulsory
Norway	1961	2,000,000 NOK	yes	no	0.00005 of assets and 0.0001 of deposits	private	compulsory
Switzerland	1984	30,000 SwF	no	no	Callable	private	voluntary

Source: Demirgüç-Kunt and Huiznga (2004) and sources given there; http://www.worldbank.org/research/Projects/bank_regulation.htm; http://www.worldbank.org/research/interest/confs/upcoming/deposit_insurance/home.htm.