TOO BIG TO FAIL

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Abstract. "Too big to fail" describes a business or business sector so ingrained in a financial system or economy that its failure would be disastrous. The government will consider bailing out a corporate entity or a market sector, such as Wall Street banks or U.S. carmakers, to prevent economic disaster. This research work aimed to describe the pattern and made discussion on the term itself. Advantages and disadvantages have been observed and conclusion made up on deep analysis and research.

Key words: Too big to fail, banks, government, economic disaster, financial stability

I. Introduction

"Too big to fail" describes a business or business sector deemed to be so deeply ingrained in a financial system or economy that its failure would be disastrous to the economy. Therefore, the government will consider bailing out the business or even an entire sector to prevent economic disaster**.**

Perhaps the most vivid recent example of "too big to fail" is the bailout of Wall Street banks and other financial institutions during the global financial crisis.

While some economists and legislators argued that too big to fail banks ultimately benefit the economy, others argued that they pose too much risk.

II. Issue

- Banks can be ‘too big to fail’ not only because of their size, but also because they are highly connected to other parts of the financial system. These banks are also referred to as systemically important banks.
- The failure of systemically important banks can put the functioning of the entire financial system at risk, and instability can spill over into the real economy.
- To prevent risks to financial stability due to the failure of systemically important banks, governments have often spent taxpayers’ money to rescue such banks in the past.
- After the global financial crisis, regulatory reforms have been implemented that tackle the ‘too big to fail’ problem by making crises less likely and less costly.
- These reforms have contributed to reducing financial stability risks arising from ‘too big to fail’ banks, but monitoring reform outcomes and risks in other parts of the financial system remains important.

During the first decade of the 21st century, the expansion in home ownership created a housing boom. It was largely fueled by mortgage loans that offered flexible qualification requirements and as a result, they opened home ownership to thousands of people who could not previously qualify to buy their home. Insurance companies used the new mortgages as collateral to generate funds with risky, exotic investment tools, earning even more money in the process.

Ultimately, the very thing that fueled the housing boom proved to be it's undoing. After a few years, many borrowers struggled to make their payments. This led to rising wave of defaults and foreclosures. The investments that banks assumed would generate profits suddenly became worthless. At first, only smaller banks and lenders were effected. But by 2008, even the largest banks started losing millions, putting them in very real danger of collapse. The collapse of Lehman Brothers only reinforced the gravity of the situation.

In effort to save the banks, the government bailed them out, lending them

billions of dollars. This allowed the banks to regain their financial footing and return to profitability. But the bailout provoked a firestorm of controversy. Since then, politicians and economists have argued whether or not the 'too big to fail banks' were worth the trouble.

III. Advantages

The proponents of too big to fail banks argue that their biggest advantage is their sheer size. They have an ability to bring their services to customers all across the borders and throughout the world. They can conduct large financial operations using enormous sums of money. This allows them to provide more services, to more people, than their smaller counterparts. They can lend in developing countries, which often don't have strong financial institutions of their own.

Furthermore, their size and their capital allow them to provide those services at cheaper rates than their smaller counterparts. Proponents of too big to fail banks argue that this makes them uniquely equipped to help to economy and encourage development in county and throughout the world

IV. Disadvantages

The opponents of too big to fail banks argue that the fallout from the collapse of too big to fail banks far outweigh their benefits. They also argue that while banks can certainly grow large, they can do everything without growing more than $100 billion in size. Most 'too big to fail' banks grew several times that number. For example, Citigroup had over $2.5 trillion in assets.

Some opponents argue that while large banks can muster sizable resources, smaller banks are much more attuned to the unique needs of their particular location and are better equipped to use their funds efficiently.

V. Solving

The proposed solutions to the "too big to fail" issue are controversial. Some options include breaking up the banks, introducing regulations to reduce risk, adding higher bank taxes for larger institutions, and increasing monitoring through oversight committees.

- **Breaking up the largest banks**

More than fifty economists, financial experts, bankers, finance industry groups, and banks themselves have called for breaking up large banks into smaller institutions. This is advocated both to limit risk to the financial system posed by the largest banks as well as to limit their political influence.

- **Reducing risk-taking through regulation**

Banks are required to maintain a ratio of high-quality, easily sold assets, in the event of financial difficulty either at the bank or in the financial system. These are liquidity requirements.

- **Too big to fail tax**

Economists propose a tax to internalize the massive costs inflicted by "too big to fail" institution. "When size creates externalities, do what you would do with any negative externality: tax it. The other way to limit size is to tax size. This can be done through capital requirements that are progressive in the size of the business (as measured by value added, the size of the balance sheet or some other metric).

- **Monitoring**

Policy researches and development entities better to observe the processing of most costly banks and realize a list which will make it easy to recognize the problem beforehand. Collecting the list of banks worldwide which are considered as too big to fail or "systemically important financial institutions"—financial organizations whose size and role meant that any failure could cause serious systemic problems.

VI. Conclusion

Overall, the case is not closed. Indicators of bank behavior and systemic risk

have moved in the intended direction, and public authorities now have the tools to deal with failing banks. But we cannot really know whether a bank is too big to fail until it fails and we see how the authorities deal with it. Solving the "too big to fail" problem is an ongoing project. Regulations addressing systemic risk externalities have to be implemented and enforced. Other financial intermediaries have entered the scene, and non-bank financial intermediation has gained in importance. Even if the "too big to fail" problem has been mitigated in the banking system, it could arise in the non-bank financial sector. Addressing "too big to fail" risks and monitoring risks to financial stability therefore remain a priority.

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