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## Bank Capital Requirements: A Quantitative Analysis

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### Abstract

This paper examines the welfare implications of bank capital requirements in a general equilibrium model in which a dynamic banking sector endogenously determines aggregate growth. Due to government bailouts, banks engage in risk-shifting, thereby depressing investment efficiency; furthermore, they over-lever, causing fragility in the financial sector. Capital regulation can address these distortions and has a first-order effect on both growth and welfare. In the model, the optimal level of minimum Tier 1 capital requirement is 8%, greater than that prescribed by both Basel II and III. Increasing bank capital requirements can produce welfare gains greater than 1% of lifetime consumption.

**Keywords:** Bank regulation, Capital requirements, Risk-shifting, Bailout guarantee, Basel II, Basel III**JEL Classification:** G28, G21[Suggested Citation](#) >[Show Contact Information](#) >

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