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Fixed Costs and Capital Regulation: Impacts on
the Structure of Banking Markets and Aggregate
Loan Quality

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Abstract

We analyze the interaction among market competition, capital regulation, fixed regulatory compliance costs, and the portfolio and monitoring decisions of banks. We examine how the interplay among the effects of changes in the degree of competition and capital requirements regulation influence optimal bank choices and market outcomes. Furthermore, we evaluate how ratcheting up the Basel regulatory regime is likely to influence both the competitive structure of banking markets and the overall quality of bank loans. Higher capital requirements and increased fixed costs reduce the degree of competition in banking markets. The weight

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