Referee Report for the Paper

Banking Concentration and Financial Stability
New Evidence from Developed and Developing Countries

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Summary

The manuscript "Banking Concentration and Financial Stability - New Evidence from Developed and Developing Countries" aims at analyzing the relationship between banking concentration and financial (in)stability. Financial instability is defined as the occurrence of a systemic banking crisis. The topic of the paper is very up-to-date and of high relevance for policy makers. However, despite the interesting topic, in my opinion the paper would have to be substantially revised.

Comments

(1) In the introduction the authors should state more clearly the contribution(s) to the existing literature. In this regard, they should shortly explain what exactly they mean by direct and indirect effects and how they are able to discriminate between the two. They mention that they use a very large panel compared to other studies. However, this fact alone might not necessarily deliver "more robust empirical results than those so far existing in the literature".

(2) With regard to the empirical approach, it is hard to believe that all explanatory variables are really exogenous. For instance, it is very likely that GDP growth in period t is affected by a banking crisis that occurred in the same period. Taking lags of the variables on the right hand side could mitigate this problem to some extent and would also be theoretically more convincing as delayed effects of the explanatory variables on financial (in)stability are more likely. Beyond that, the crisis dummy could be one in period t because of a banking crisis at the very beginning of the year.

(3) In addition, the empirical analysis could potentially suffer from an omitted variable bias. Thus, the authors should check the robustness of their results when including additional explanatory variables that are likely to affect financial stability. Candidates could be, for instance, private sector debt, total financial liabilities, a measure of financial development, interest rates, and the monetary policy regime. In order to check if a previous boom period represents an important trigger for a future crisis it could also be reasonable to include a measure of the output gap in the past, for instance. Furthermore, since diversification is mentioned as an important channel in the literature review, it might be worthwhile to take that up again in the subsequent analysis.

(4) The authors mention that they use a GMM approach to estimate equation (3) and equation (4). They should be more explicit about their motivation to do so and explain their approach in more detail. They mention that they examine the validity of instruments without stating what is instrumented by what.

(5) To get a better feeling about the crisis dummy, it would be interesting to see how many countries in the data set faced no crisis at all and how many countries faced only one crisis in the sample period.

(6) The authors should not only comment on statistical significance but also on economic significance when discussing the regression results. In particular, they should discuss the marginal effect of a change in regressors for the probability that a crisis occurs (see, for instance, Table 3). Otherwise, it is difficult to assess what a coefficient estimate of, say, -0.0114 actually means.

(7) The authors should provide details about the different test statistics they list at the bottom of each Table. For instance, it is probably unclear to most readers what is meant by "chibar2(01)".

(8) In the abstract and introduction 173 countries are mentioned. However, in all tables it is stated that the number of countries is 156. This should be clarified. From page 4 the reader gets the impression that per capita GDP (PGDP) is included in the set of macroeconomic control variables (X). However, it is not listed in the regression output in Table 3. This also should be clarified.

(9) Finally, the paper lacks thorough editing and proofreading. Examples: Missing subscripts in all model equations, "T-Student are reported…" (see Table 5), Usage of the term "correlation" (see p.6/7), "profit model" (p.8), Table 6 is presented after Table 8, etc.