

February 2012

Turning Bagehot on His Head: Lending at Penalty Rates When Banks Can Become Insolvent

Fabio Castiglionesi
Wolf Wagner

Summary

Ever since Bagehot's (1873) pioneering work, it is a widely accepted wisdom that in order to alleviate (ex ante) bank moral hazard, a lender of last resort should lend at penalty rates only. In a model in which banks are subject to shocks but can exert effort to affect the likelihood of these shocks, authors show that the validity of this argument crucially relies on banks always remaining solvent.

To view this article in its entirety please use the link provided below.

[View Full Article](#)

Recommended Citation

Castiglionesi, Fabio, and Wolf Wagner. 2012. "Turning Bagehot on His Head: Lending at Penalty Rates When Banks Can Become Insolvent." *Journal of Money, Credit and Banking* 44, No. 1. <https://www.jstor.org/stable/pdf/41336820.pdf>.