Abstract
Using a measure of competition based on the Panzar-Rosse model, this paper explains bank competition across 76 countries on the basis of various determinants. Studies explaining banking competition are rare and typically insuffciently robust as they are based on a limited number of countries only. Traditionally, market structure indicators, such as the number of banks and banking concentration, have been considered the major determinants of competition in the banking sector. However, we find that these variables have no significant impact on market power. Instead, we show that a country's institutional framework is a key factor in explaining banking competition. Extensive regulation, particularly antitrust policies, improves the competitive environment. The foreign investment climate, a proxy of contestability, also plays an important role. The fewer restrictions on foreign investments exist, the more competitive the banking sector becomes. In addition, activity restrictions make large banks less competitive and collusion markups are procyclical. Finally, competition is substantially weaker in countries with a socialist past, such as Central- and Eastern Europe.