

# Policy Responses to Banking Crises over the Longer Run

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# Propensity of governments to provide bailouts – a longer run view

- Some dynamic predictions can be inferred from the comparative statics literature in this area:
- **Factors constraining bailout propensity:**
  - Democratization since 1970s (Keefer 2007; Rosas 2006)
  - Rising financial openness (Mosley 2003, Obstfeld 1998)
  - Rise of neoliberal ideas (Blyth 2013; Farrell & Quiggin 2011)
- **Factors increasing bailout propensity:**
  - Rising structural power of financial sector (Culpepper & Reinke 2014; Woll 2014, 2016)
- Uncertain dynamic implications, but powerful factors promoting greater constraint on bailouts

# Our argument: “Bailout constituency” growing over time

- Democracy interacts with financialization & rising leverage to increase societal demand for bailouts
- Financialization (Haldane, Kay, Kruppner)
  - Securitization increases market complexity & system interconnectedness
  - Rise of middle class wealth: deposits, housing, pensions
- Leverage (Jorda, Schularick & Taylor)
  - Vast expansion of mortgage credit in 20C
- Both increase demand for asset price & “systemic” bank protection, especially by the middle class

## **“Traditional” Bagehot constituency**

- Solvent banks
- Their investors, creditors, customers
- Welfare recipients
- Public sector workers
- Taxpayers



## **Traditional Bailout constituency**

- Insolvent banks
- Their investors, creditors, customers



## **New Bailout constituency**

- Most banks
- Their investors & creditors
- Other investors & creditors in related securities markets
- Households with pension & other funds
- Mortgage customers

# Hypotheses

1. Financialization will be positively associated with Bailout policy responses to banking crises, irrespective of regime type
2. Democracy will be positively associated with Bailout policy responses to banking crises
3. Financialization will condition the impact of democracy on policy responses to banking crises, and:
  - A. Democratic governments will be more likely to implement Bailout policies as financialization rises

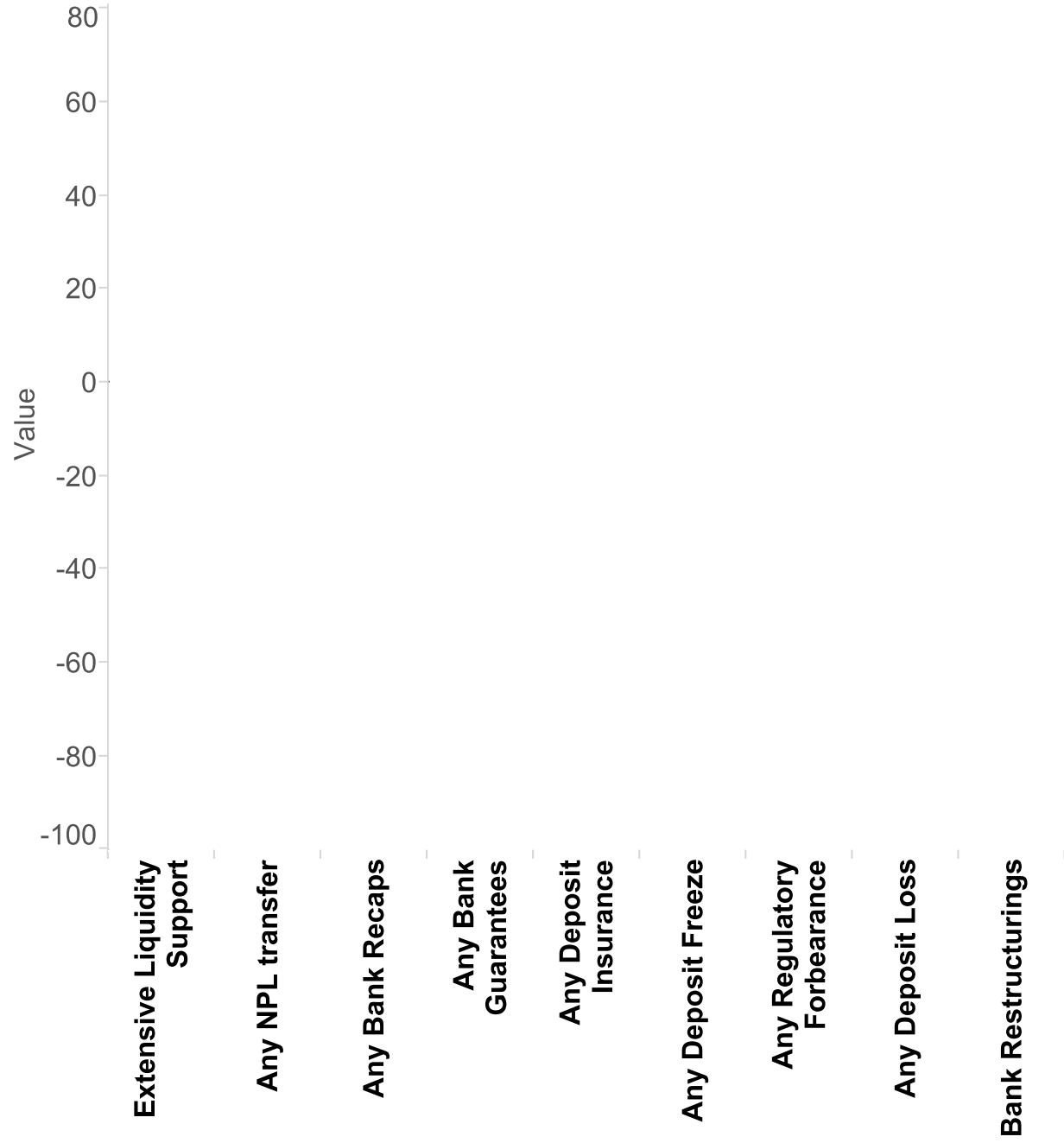
# Data and Method

- 122 “systemic” crisis episodes 1976 – 2009; OLS Regression
- Democracy (Polity IV)
- Financialization
  - Liquid Liabilities / GDP
  - Deposit Money Bank Assets / GDP
  - Deposit Money Bank Share of Total Financial Assets
  - Bank Concentration
  - Private Credit / GDP
  - Financial System Deposits / GDP
  - Stock Market Tradable Value / GDP
  - Private Bond Market Capitalization / GDP
  - Stock Market Tradable Value + Private Bond Market Capitalization / GDP
  - Residential property prices
  - Income inequality
  - Capital Account Openness
- Interaction terms
- Controls: GDP Per Capita, Exchange Rate Regime, Public Debt / GDP, Trade Openness

# “Bagehot” or “Bailout”?

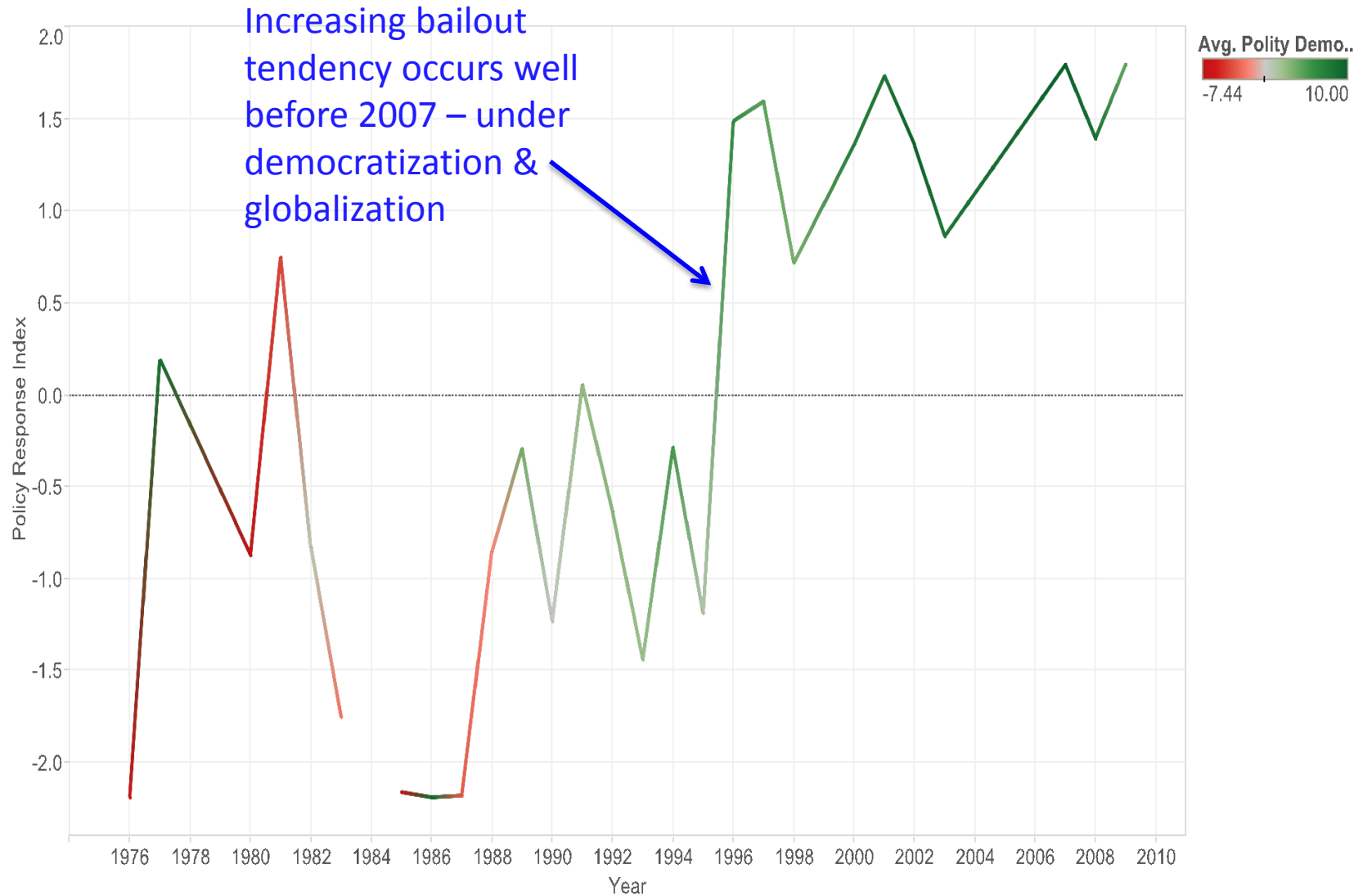
<b>Policy Issue</b>	<b>Bagehot</b>	<b>Bailout</b>
<b>Last-Resort Lending</b>	Monetary authorities lend on good collateral, for a limited duration, at penalty rates	Monetary authorities provide open-ended support, as requested by banks
<b>Nonperforming Assets</b>	Banks forced to write non-performing assets off their balance sheets	Public sector assumes non-performing assets  Debt relief program for distressed borrowers
<b>Bank Recapitalization</b>	Private sector recapitalization	Public sector recapitalization  Regulatory forbearance
<b>Socialization of Liabilities</b>	Little, if any, protection for liability holders	Blanket protection of liability holders
<b>Exit Policy</b>	Bank closed or restructured after insolvency detected	Insolvent banks permitted to continue operations

# Measuring Policy Responses





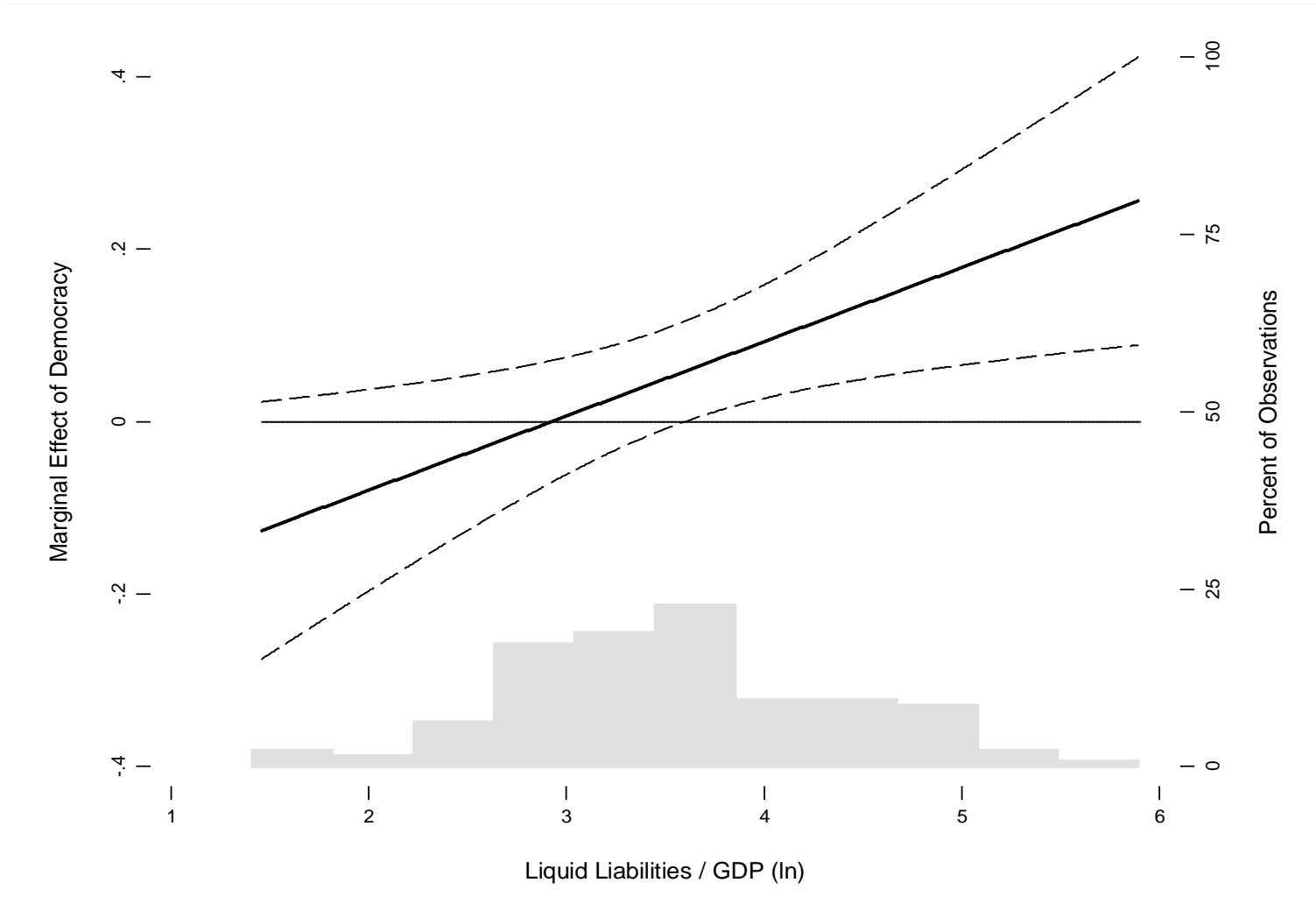
# Average policy response scores since 1976



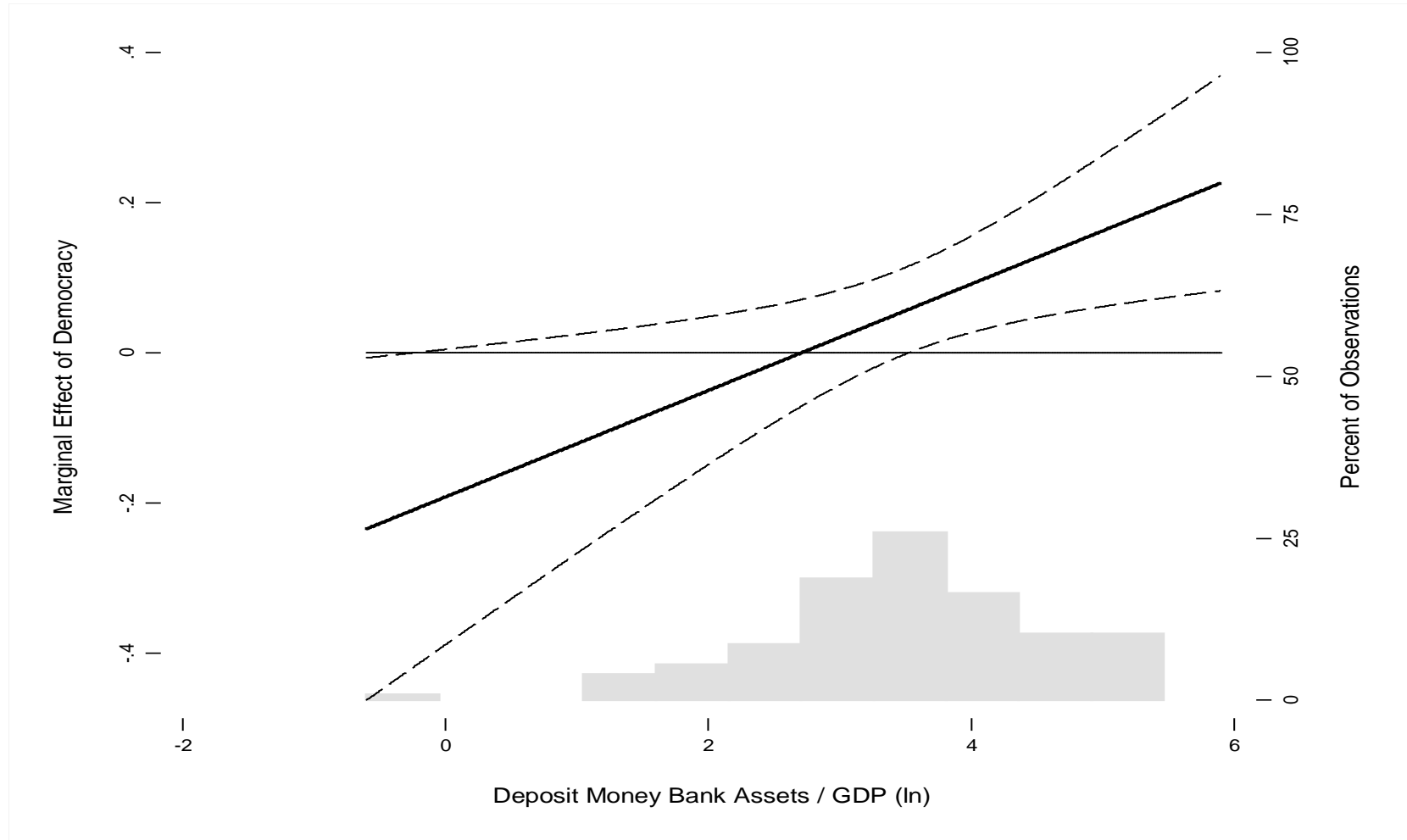
# General results

- Bailout responses also associated with higher housing prices, leverage, income inequality, & redistribution
- Democracy has a consistently + relationship with bailouts
- Financialization conditions the relationship between democracies & bailouts
  - Larger banks, higher leverage, and greater bank-based financial inclusion and wealth

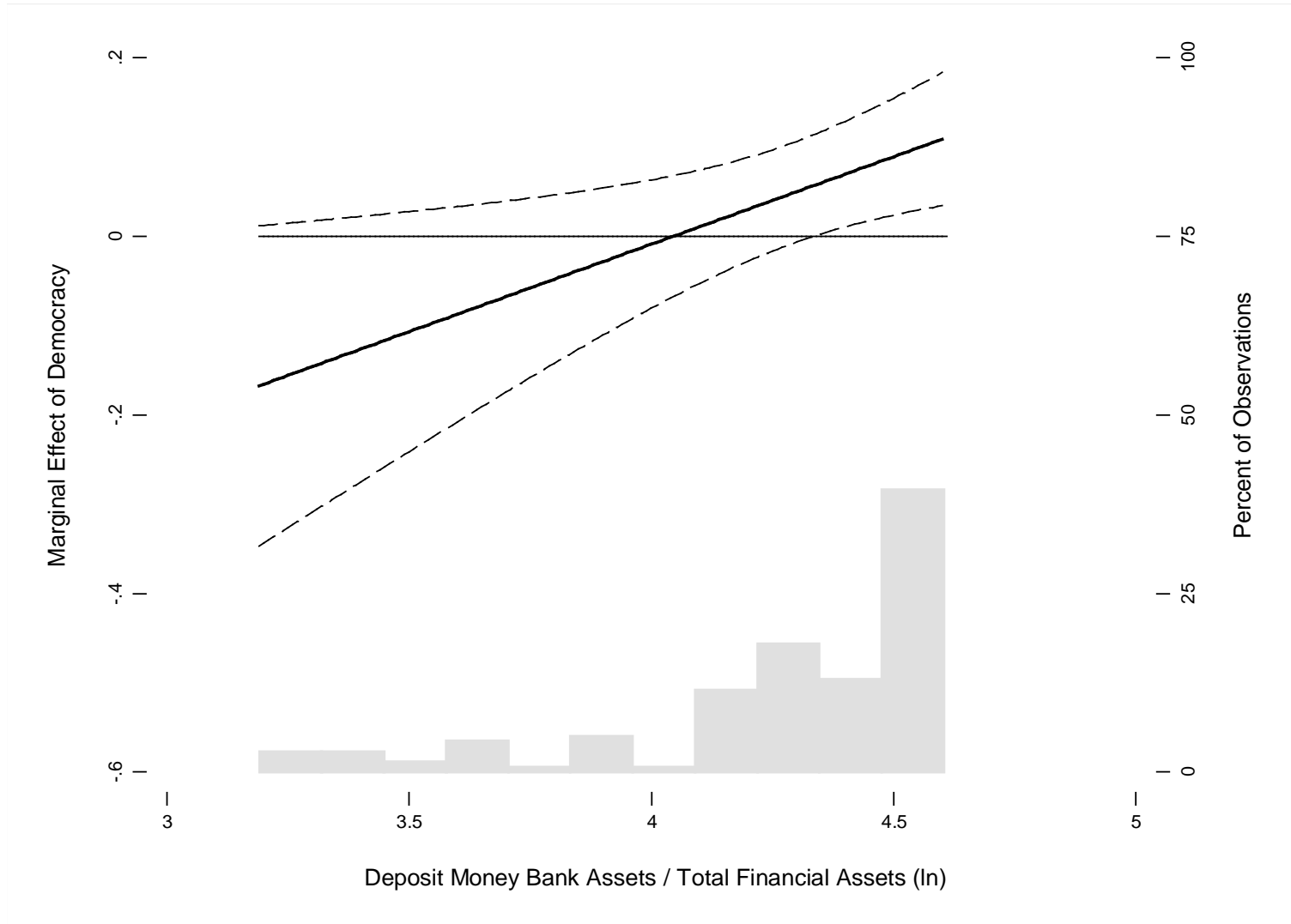
# Financialized Democracies: Liquid Liabilities



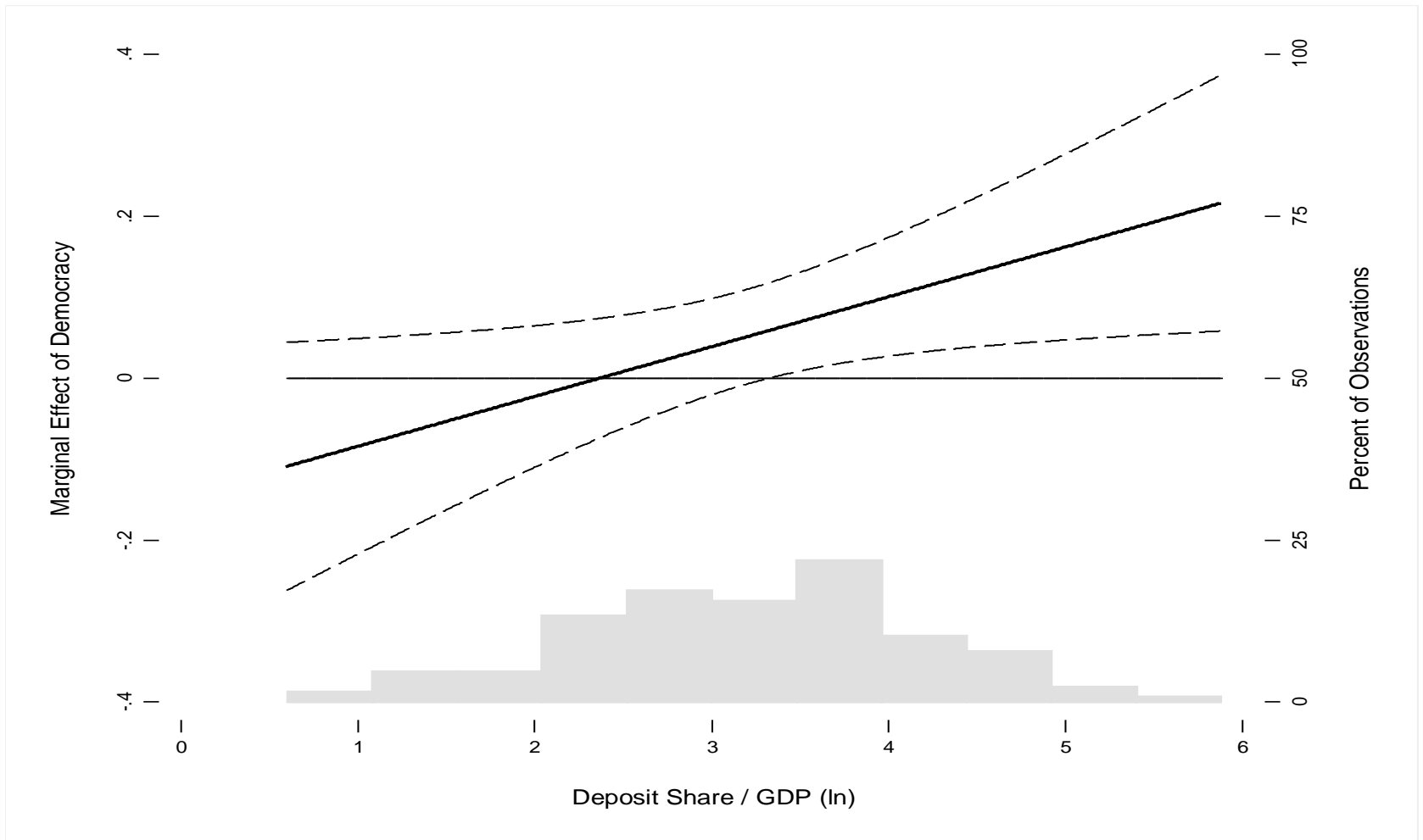
# Financialized Democracies: Deposit Money Bank Assets



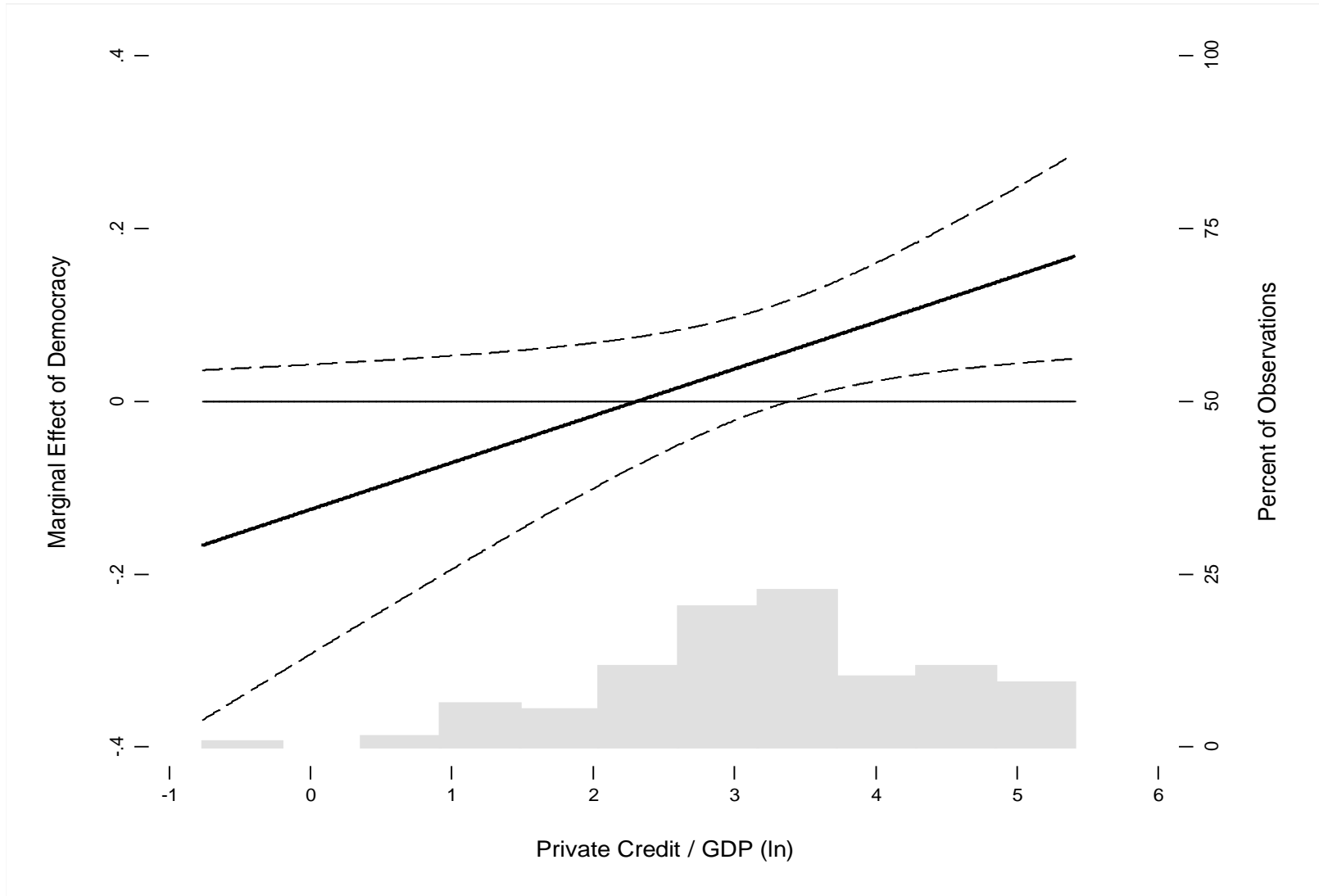
# Financialized Democracies: Deposit Money Bank Asset Share



# Financialized Democracies: Deposit Share



# Financialized Democracies: Private Credit



# Conclusion

- Dynamic “Minskian” cycle? Financialization, systemic fragility & more extensive interventions
- Deep political roots: not just “cronyism”; also stabilization politics in advanced democracies with rising middle class wealth & leverage
- Evidence supports the view that the differences between CMEs & LMEs are eroding
- Globalization also imposes little constraint on bailouts; but may generate more crises