

# Policy Responses to Banking Crises over the Longer Run

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

- **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

# Increasing middle class wealth generates a growing “bailout constituency”

- Growing middle class financial wealth and inclusion
  - Rise of deposits (Jaremski & Rousseau)
  - Housing equity: vast expansion of mortgage credit in 20C
  - Pensions – broadening of the “investor class”
- System fragility
  - Securitization increases network complexity & interconnectedness (“financialization” – Haldane, Kay, Krippner)
  - Rise of leverage – consumption + housing assets (Rajan; Jordà, Schularick & Taylor)
- Demand for asset & SIB protection “from below”
  - Deposit insurance first, but increasingly housing & (defined contribution) pension assets
  - Systemically important financial institutions TITF
  - A different source of “structural power” for SIFs

## “Traditional” Bagehot constituency

- Solvent banks
- Their investors, creditors, customers
- Taxpayers
- **Public sector beneficiaries**



## Traditional Bailout constituency

- Insolvent banks
- Their investors, creditors, customers



## New Bailout constituency

- **Most banks**
- **Their investors & creditors**
- **Other investors & creditors in related securities markets**
- **Middle class households with deposits, housing & pension assets**

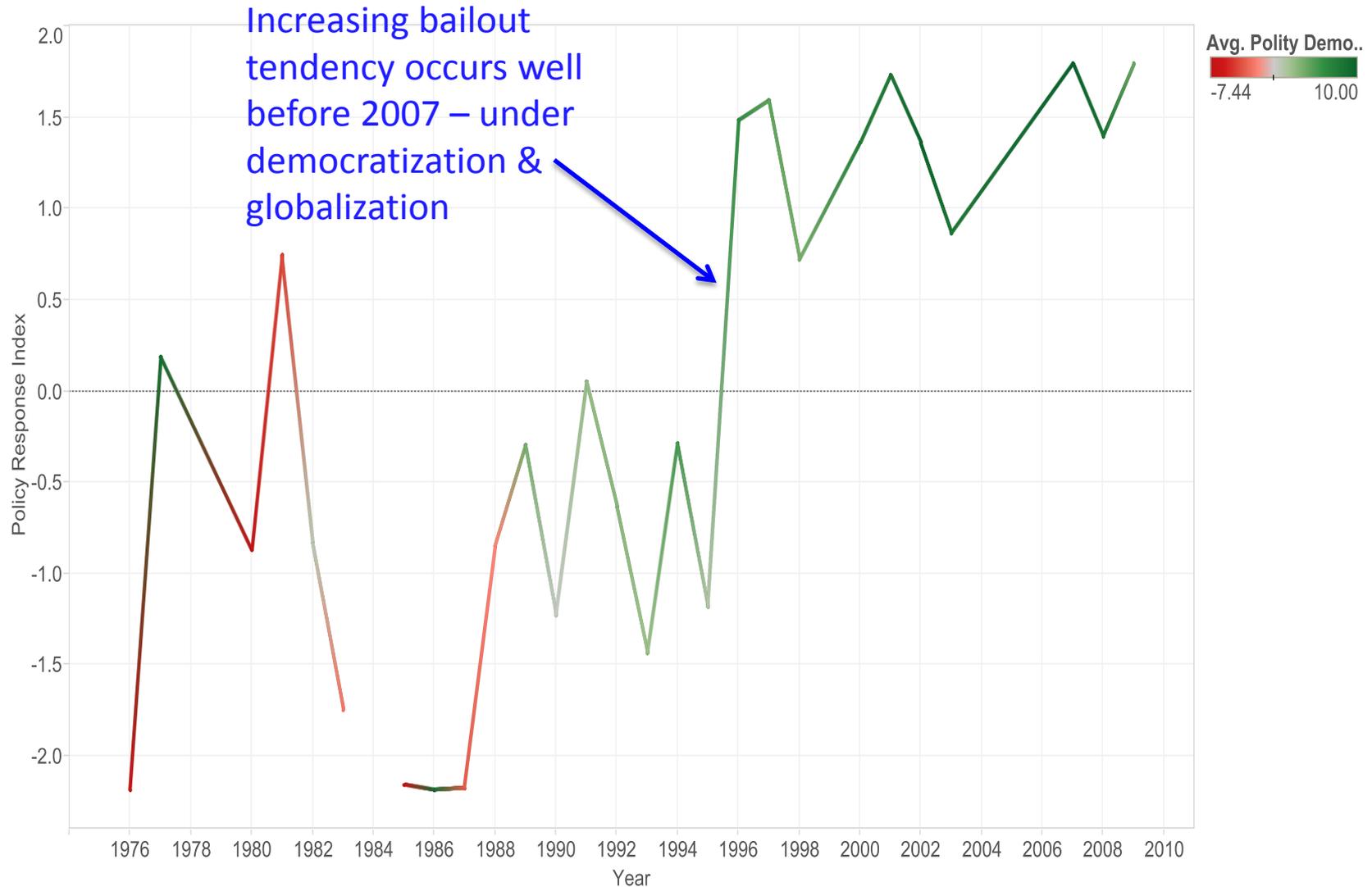
# Hypotheses

1. Growing financial wealth and inclusion heighten the propensity for Bailout policy responses
2. Financialization and leverage will heighten the propensity for Bailout policy responses
3. These will condition the impact of democracy on policy responses to banking crises, and:
  - Democratic governments will be more likely to implement Bailout policies as financial wealth and systemic fragility rise

# Coding scheme

Policy Issue	Bagehot	Bailout	Indicator
Last-Resort Lending	Monetary authorities lend on good collateral, for a limited duration	Monetary authorities provide open-ended support, as requested by banks	Extensive / Open-Ended Bank Liquidity (+1)
Nonperforming Assets	Banks forced to write non-performing assets off their balance sheets	Public sector assumes non-performing assets Debt relief program for distressed borrowers	Public AMC or Debt Relief Program (+1)
Bank Recapitalization	Private sector recapitalization	Public sector recapitalization Regulatory forbearance	Recapitalization or Nationalization (+1)
Socialization of Liabilities	Little, if any, protection for liability holders	Blanket protection of liability holders	High State Bank Presence / Explicit Guarantee (+1) New Deposit Insurance (+1) Deposit Freeze / Bank Holiday (+1) Deposit Loss (-1)
Exit Policy	Banks closed or restructured after insolvency detected	Insolvent banks permitted to continue operations	Bank Restructuring (-1)

# Average policy response scores since 1976



# Assessing Financial Wealth and Inclusion

- Financial wealth increasingly held in deposits, stocks, bonds, and housing
  - Deposit Share / GDP
  - Stock Market Tradable Value / GDP
  - Private Bond Market Capitalization / GDP
  - Stock Market Tradable Value + Private Bond Market Capitalization / GDP
  - Residential Property Prices

# Assessing Financialization

- Size
  - Absolute size
    - Liquid Liabilities / GDP [financial depth]
  - Relative importance of private sector credit allocation
    - Deposit Money Bank Assets / GDP
    - Deposit Money Bank Assets / Total Financial Assets
- Market Structure
  - Concentration
    - Three largest banks' assets / Total Financial Assets

# Assessing Financialization

- Prevalence of financial innovation, complexity, and interconnectedness
  - Stock Market Tradable Value / GDP
  - Private Bond Market Capitalization / GDP
  - Stock Market Tradable Value + Private Bond Market Capitalization / GDP
- Leverage
  - Private Credit / GDP
  - Gini coefficient

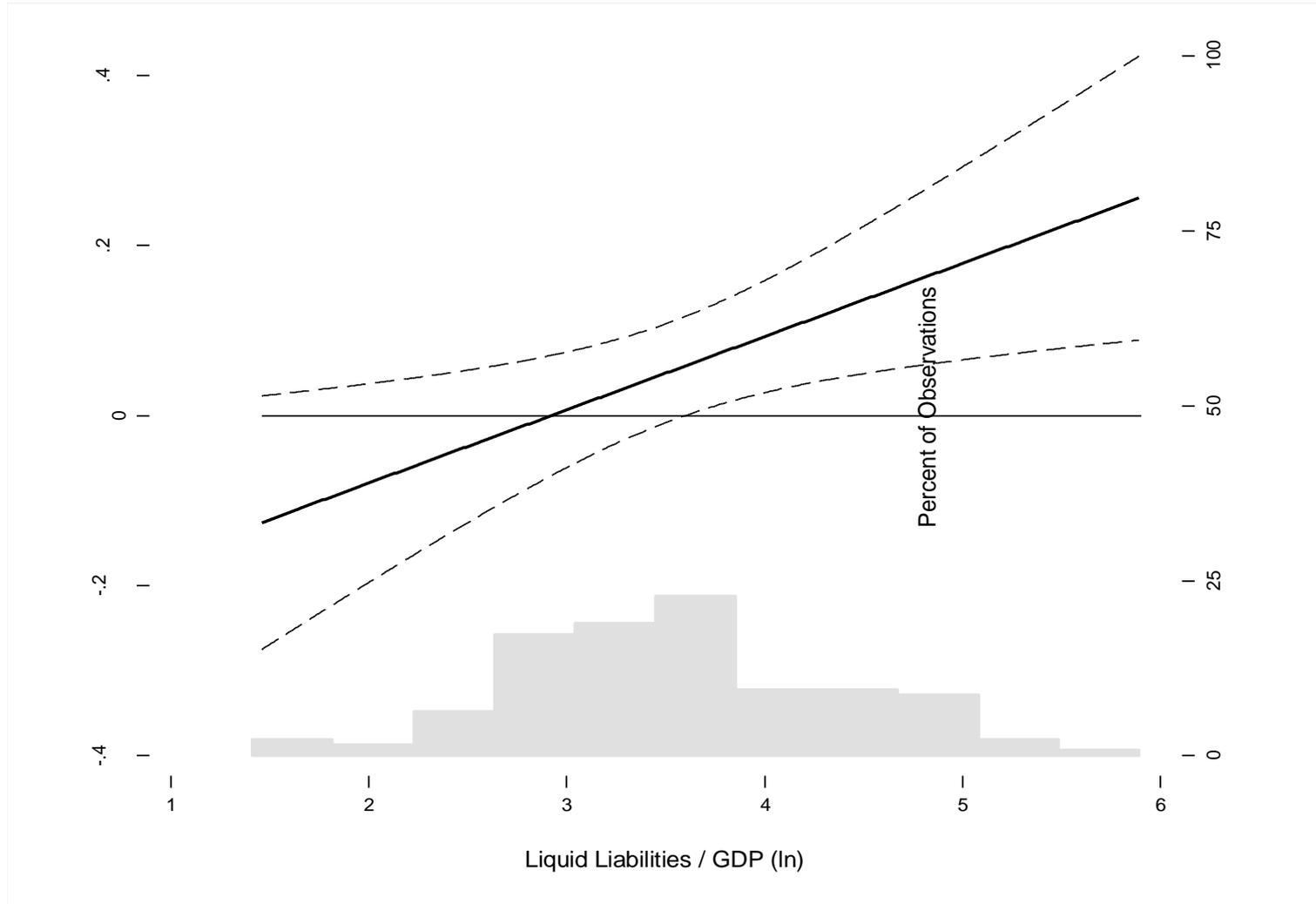
# Data and Method

- 122 “systemic” crisis episodes 1976 – 2009
- OLS Regression
- Democracy (Polity IV)
- Financialization
- Interaction terms
- Controls:
  - GDP Per Capita
  - Exchange Rate Regime
  - Public Debt / GDP
  - Capital Account Openness
  - Trade Openness

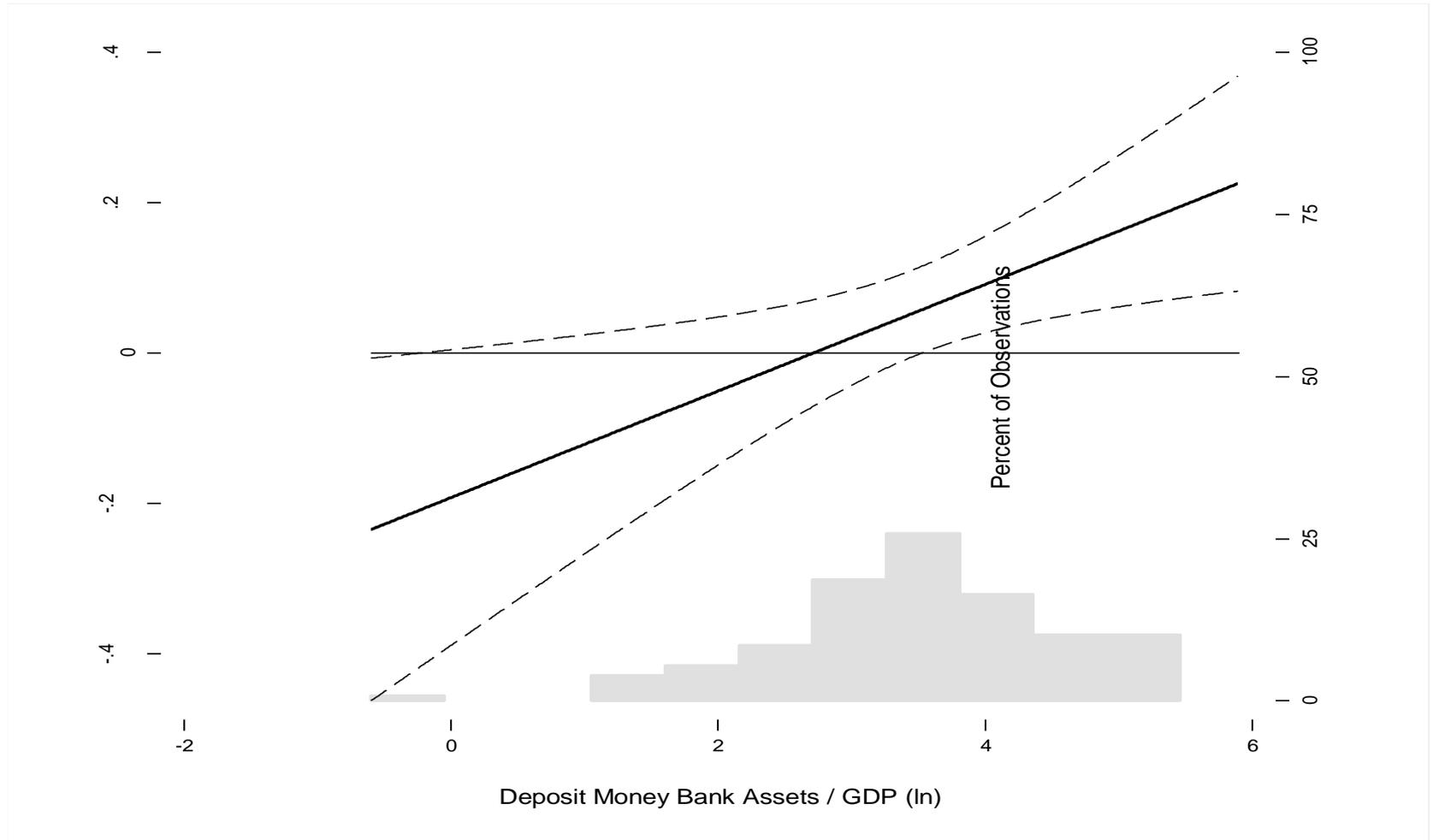
# General results

- Bailout responses associated with higher stock market tradable value, housing prices, and inequality
- Financial wealth and inclusion, financialization, and leverage condition the relationship between democracies & bailouts

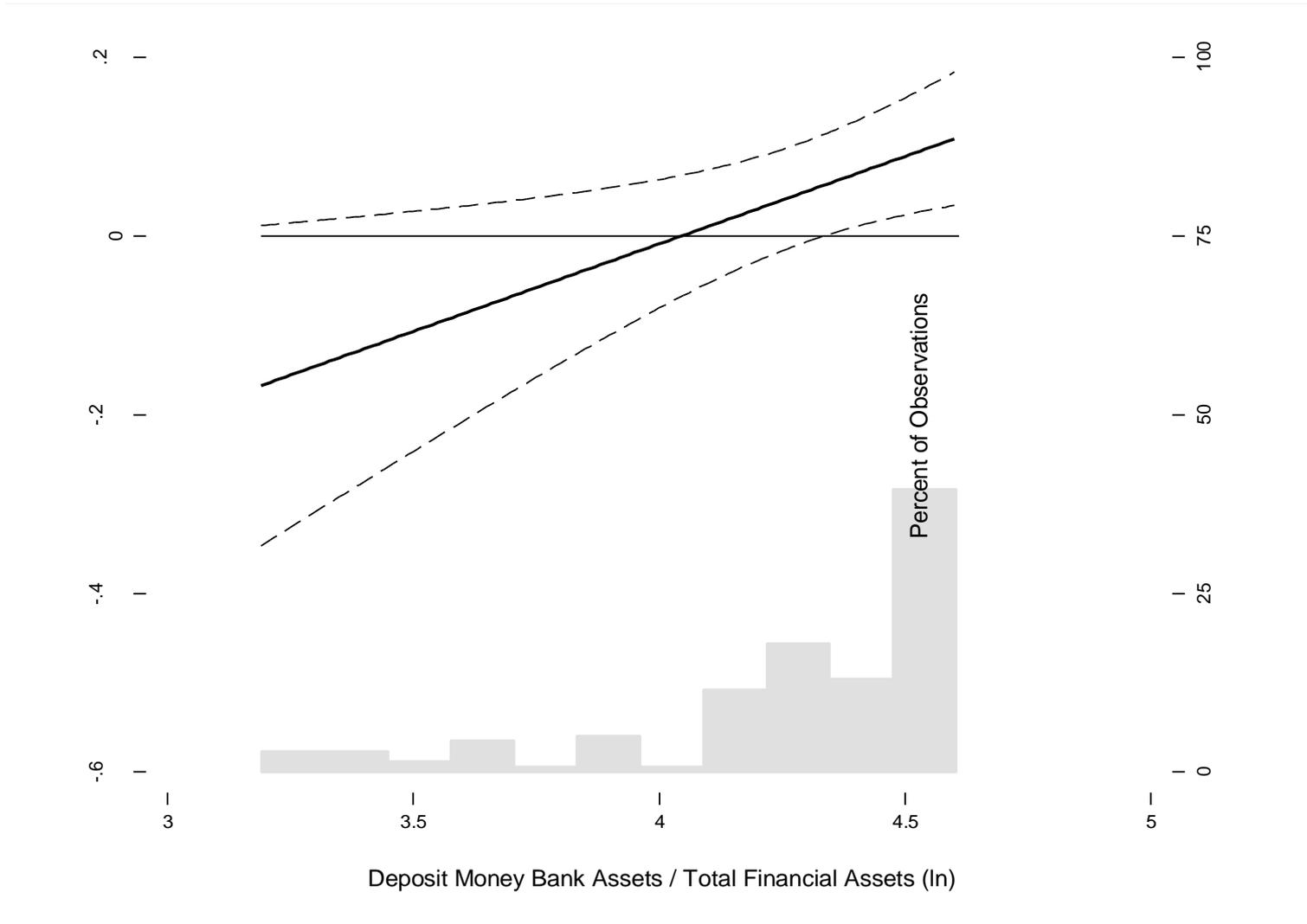
# Financialized Democracies (Size): Liquid Liabilities



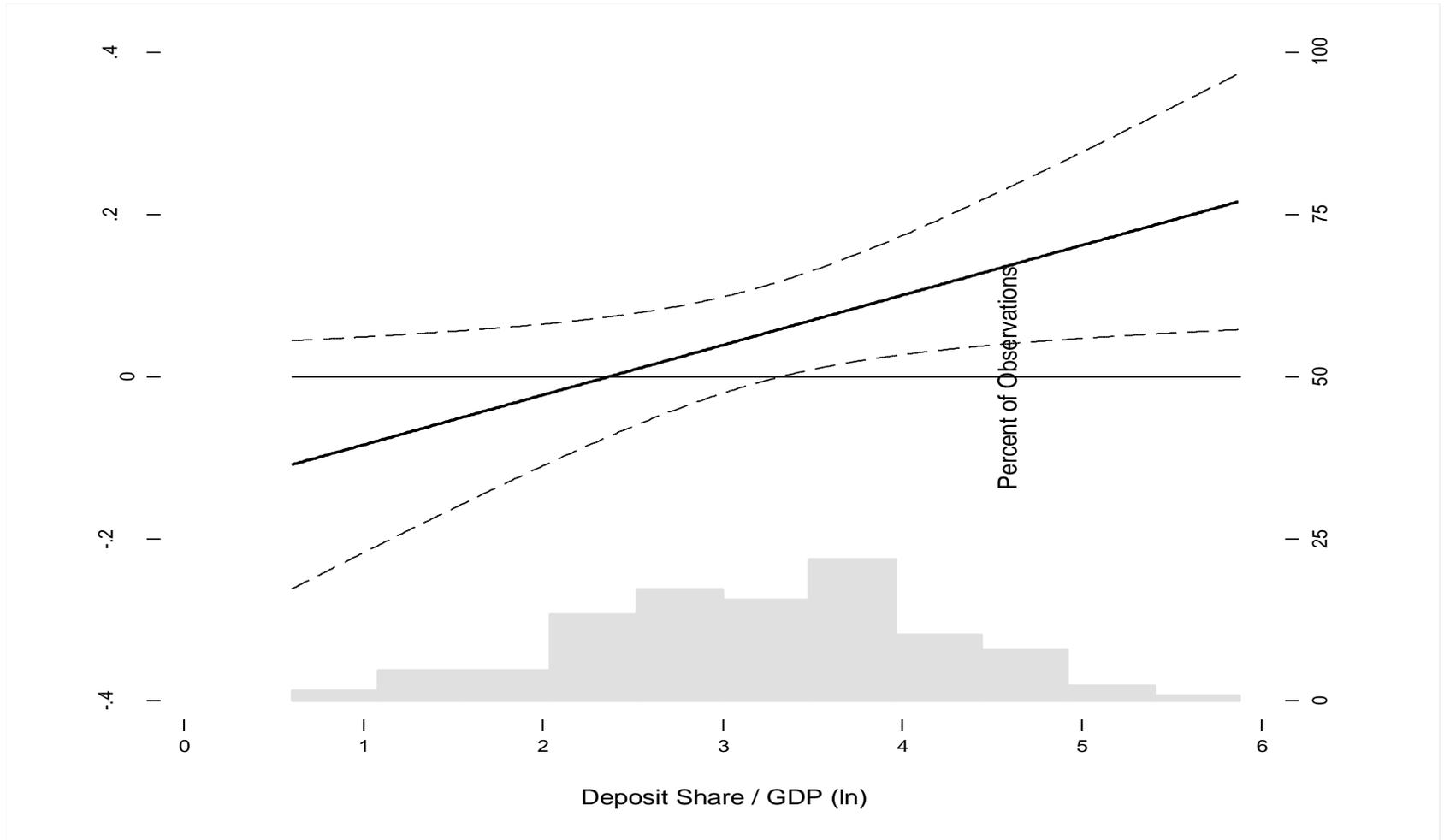
# Financialized Democracies (Size): Deposit Money Bank Assets



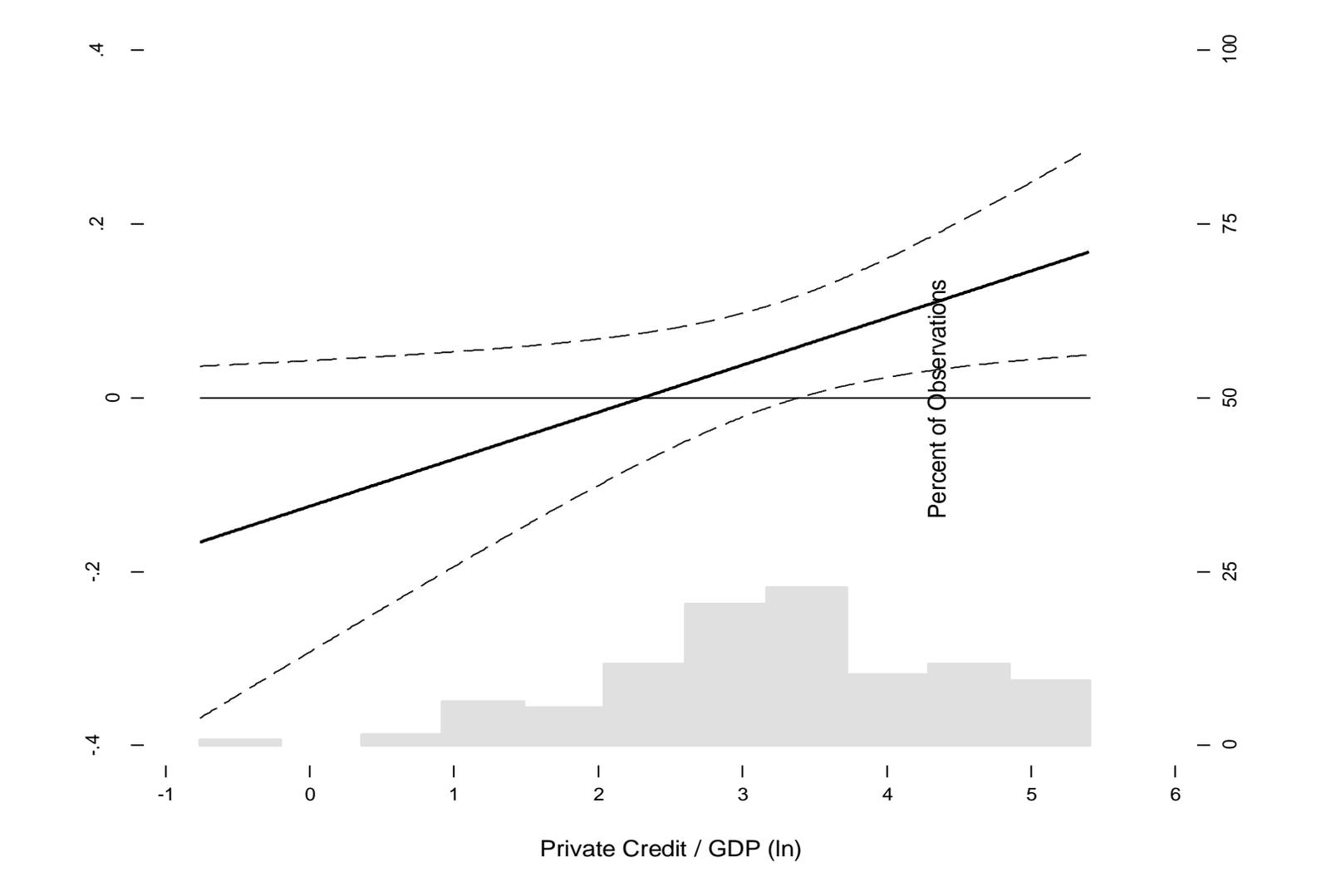
# Financialized Democracies (**Size**): Deposit Money Bank Asset Share



# Financialized Democracies (**Wealth**): Deposit Share



# Financialized Democracies (Leverage): 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