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What do we know about the impact of government interventions in the banking sector? An assessment of various bailout programs on bank behavior

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Abstract

Systemic banking crises have placed enormous pressure on national governments to intervene. The empirical literature, however, is inconclusive on what an optimal bailout program should look like to mitigate the negative consequences of government interventions in the banking sector. We find that, in general government interventions have a negative impact on banking sector stability, significantly increasing its risk. In particular, we find that among bailout measures, nationalization and asset management companies (AMCs) contribute most to the risk effect and that among liquidity support mechanisms, public guarantees are the largest contributor to the risk effect. However, we also find that by making an appropriate choice of intervention mechanisms, governments can mitigate the negative consequences stemming from the above-mentioned effects.

Keywords: Government Interventions, Crisis, Bailout, Moral Hazard, Financial Stability

JEL Classification: G21, G28

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