



Economic Review

The Macroeconomic Fallout of Shutting Down the Banking System

by: Qian Chen, Christoffer Koch, Gary Richardson and Padma Sharma

November 18, 2020

Preventing the suspension of bank deposits during recessions may also prevent longer-term economic losses.

During the 2008–09 financial crisis, the U.S. government arranged bailouts of major banks to prevent a suspension of bank deposits, where banks cease paying checks and refuse depositors’ requests to withdraw funds. Although these bailouts likely helped firms and households continue to make payments, they have been debated due to potential moral hazard concerns as well as the high cost to taxpayers. Assessing the costs and benefits of preventing deposit suspensions is difficult, as nationwide bank suspensions have not occurred since the Great Depression.

To circumvent this challenge, Qian Chen, Christoffer Koch, Gary Richardson, and Padma Sharma study the effects of more recent deposit suspensions at the state level (Nebraska in 1983, Ohio and Maryland in 1985, and Rhode Island in 1991). They find that the suspension in Rhode Island, which occurred during a recession, lowered employment, gross state product, and per capital personal income. Their results suggest that interventions that prevent large deposit suspensions during recessions, such as those undertaken after 2008, are likely worth the costs. Effective interventions not only help avoid economic losses during recessions, but also prevent losses to output and employment several years into the future.

Publication information: Vol. 105, no. 2

DOI: 10.18651/ER/v105n2Sharma

Author



Padma Sharma

Senior Economist

Padma Sharma is a Senior Economist at the Federal Reserve Bank of Kansas City. She joined the Economic Research Department in July 2019. Prior to joining the department, she completed her Ph.D. in economics from the University of California at Irvine. Padma received her B.S. degree in economics, mathematics and statistics from Bangalore University and M.S. in economics from Indira Gandhi Institute of Development Research. Padma's main areas of research are in financial economics and econometrics. Her research papers involve the development of Bayesian estimation methods that address research questions pertaining to banking and financial stability.
