Research Working Papers

Do Bank Bailouts Reduce or Increase Systemic Risk? The Effects of TARP on Financial System Stability

by: Raluca A. Roman, Allen N. Berger and John Sedunov

May 10, 2017

The TARP bailout significantly reduced contributions to systemic risk, particularly for large banks, safe banks, and banks located in strong local economies. These reductions occurred primarily through a capital cushion channel.

RWP 16-08, September 2016

Theory suggests that bank bailouts may either reduce or increase systemic risk. This paper is the first to address this issue empirically, analyzing the U.S. Troubled Assets Relief Program (TARP). Difference-in-difference analysis suggests that TARP significantly reduced contributions to systemic risk, particularly for larger and safer banks located in better local economies. This occurred primarily through a capital cushion channel. Results are robust to additional tests, including accounting for potential endogeneity and selection bias. Findings yield policy conclusions about the wisdom of bailouts, which banks might be the best targets for future bailouts, and the form these bailouts might take.

JEL Classification: G18, G21, G28

Article Citations

- Roman, Raluca A., Berger, Allen N., Sedunov, John. 2016. "Do Bank Bailouts Reduce or Increase Systemic Risk? The Effects of TARP on Financial System Stability," Federal Reserve Bank of Kansas City, Working Paper no. 16-08, September, available at https://doi.org/10.18651/RWP2016-08.

Related Research

- Berger, A. N., Makaew, T., Roman, R. A., 2016. Do Borrowers Benefit from Bank Bailouts during Financial Crises? The Effects of TARP on Loan Contract Terms, Working Paper, University of South Carolina.
- Berger, A. N., Roman R. A., 2015. Did TARP Banks Get Competitive Advantages? Journal of Financial and Quantitative Analysis 50, 1199-1236.
- Berger, A. N., Roman R. A., Forthcoming. Did Saving Wall Street Really Save the Main Street? The Real Effects of TARP on Local Business Conditions, Journal of Financial and Quantitative Analysis.