Comments on Sharon Poczter’s ‘The Long-Term Effects of Bank Recapitalization: Evidence from an Emerging Market’

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Prepared for the Asian Bureau of Finance and Economic Research National University of Singapore, May 2013
The Issue

• Recapitalization addresses a `short-term’ concern:
  
  Crisis period triage
  
  Fragile bank with potentially viable borrowers

• Raises a long-term one
  
  Moral Hazard
This Paper

• Addresses the long-term concern
• Uses interesting, detailed Indonesian data
  – Financial
  – Political
Its Two Key Figures
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Time Series of Risk

Average Z-Score (insolvency risk)

Non-Recapitalized Firms
Recapitalized Firms

Figure 2. Time Series of Average Lending Volume between Recapitalized and Non-Recapitalized Banks
Interpretation:
moral hazard arising from recapitalization
A >> L
Not Recapitalized
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Time Series of Risk

Average Z-Score (insolvency Risk)

Treatment Effect

Without recapitalization, a grasshopper would be like an ant.
Treatment Effect

Without recapitalization, a grasshopper would be like an ant.

Treatment induces moral hazard in the grasshopper, while it does the opposite to the ant.
Three Questions
Question 1

Why would treatment induce moral hazard only in the treated?
Why doesn’t the ant learn from the grasshopper?
That is, why wouldn’t the riskiness rise for both the recapitalized and the non-recapitalized? Mightn’t the ant, too, see a greater likelihood of being bailed out in hard times?
Question 2... Indonesia?
Question 2... Indonesia?

Distinctive?
Generalizable?
Other emerging Asian Economies?
Japan, US, Europe?
Question 3: Selection
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Time Series of Risk

Average Z-Score (insolvency Risk)

15

10

5

0


Non-Recapitalized Firms

Recapitalized Firms

Basis of Identification
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Time Series of Risk

Average Z-Score (insolvency risk)

<table>
<thead>
<tr>
<th>Year</th>
<th>Recapitalized Firms</th>
<th>Non-Recapitalized Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td></td>
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<tr>
<td>2000</td>
<td></td>
<td></td>
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<tr>
<td>2005</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Before Recapitalization
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Time Series of Risk

Average Z-Score (insolvency Risk)

= 5

Before Recapitalization

Non-Recapitalized Firms

Recapitalized Firms
Question 3: What if.....?
$A \ll L$
Not Recapitalized
$\text{Corr}(FB, FP) \neq 0$

Charles H. Bennett, 1857
(Wikimedia Commons)
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Time Series of Risk

Observed risk: Survivor Only

Average Z-Score (Insolvency Risk)
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Observed risk: Survivor Only

< True risk.
Better times return, showing the ant’s prudent nature, and the grasshopper’s same old proclivity for risk.

Observed riskiness includes lucky survivor’s high capital, but excludes data from the ghosts.

**Observed risk: Survivor Only**

< True risk.
Figure 1. Time Series of Risk Measure Between Recapitalized and Non-Recapitalized Banks

Time Series of Risk

Average Z-Score (Insolvency Risk)
Treatment Effect or not?

Without recapitalization, a grasshopper would be like an ant. 
(treatment effect)

Or,

An ant is an ant, & a grasshopper is a grasshopper. 
(selection artifact)
Treatment Effect or not?

Strength of paper: Data

It would be helpful to see the data for the ghosts.