Discussion of
Gropp, Rocholl, and Saadi

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Bob DeYoung
University of Kansas
KU School of Business

Gropp, Rocholl, and Saadi

- When a commercial firm fails:
  - ➢ Bankruptcy laws ease short-term real economic disruptions.
  - ➢ Assets reallocated ➡ long-run local economic benefits.

- When a bank fails and ***regulator closes the bank***:
  - ➢ Bank re-opens Monday, no short-term real/financial disruption.
  - ➢ Assets are reallocated ➡ long-run economic benefits?

- When a bank fails and ***regulator forbears***:
  - ➢ Bank stays open, no short-term real/financial disruption.
  - ➢ Assets stay in place ➡ long-run economic costs?

This paper examines and compares the real macroeconomic effects of failed bank closures and failed bank forbearance in the U.S. in 2007-2010.

- ***This is an extremely important question for policy.***

Basic Methodology and Main Results

- Cross sectional, MSA-level data in U.S., for 2007-2010 time period.

<u>Short-term analysis:</u>

$$Real\ conditions(07\text{-}10)\ =\ a + b*closed\ bank\ assets(07\text{-}10) + e$$
$$Real\ conditions(07\text{-}10)\ =\ a + b*\widehat{forebearance}(07\text{-}10) + e$$

➢ <u>Closure</u> is ***related to weaker real conditions*** in MSA.
➢ <u>Forbearance</u> is ***related to strong conditions*** in MSA.

<u>Long-run analysis:</u>

$$Real\ conditions(11\text{-}15)\ =\ a + b*closed\ bank\ assets(07\text{-}10) + e$$
$$Real\ conditions(11\text{-}15)\ =\ a + b*\widehat{forebearance}(07\text{-}10) + e$$

➢ <u>Closure</u> has ***positive future real effects*** in MSA. ***<u>CLEANSING</u>***
➢ <u>Forbearance</u> has ***negative future real effects*** in MSA.

- **Very important issue:** The economic magnitudes of these coefficients (Section 4) are ***<u>never</u>*** discussed!

Some econometric challenges

Forbearance is not directly observable.

- Authors estimate probability of bank closure as a function of CAMELS-type variables (Wheelock and Wilson 2000). The residual provides the estimate $\widehat{forebearance}$.

- TARP was an important part of regulatory forbearance during this time period. But TARP is not discussed in paper.

  ➢ Should TARP be controlled for in the bank closure model?

  ➢ Then $\widehat{forebearance}$ would capture "non-TARP-related" forbearance.

Some econometric challenges

Policy choice (close or forbear) is endogenous to MSA conditions.

- Authors use 2SLS-IV techniques.
- The instrument is *ln*(Distance to Washington, DC).
  - ➤ **Assumption 1: Distance to DC is related to the closure versus forbearance decisions.**
    - Table 3 shows a positive association with closed assets, and a negative association with forbearance.
  - ➤ **Assumption 2: Distance to DC is unrelated to economic conditions in MSAs.**
    - But ***in this cross-section of time***, the biggest housing shocks occurred far from DC (in CA, NV, AZ, MI, OH, FL).
    - Are you capturing spurious correlation in your instrumented results?

A data issue

- Bank-level data on closed loans and forbearance are aggregated at the MSA level, ***based on the headquarters location of banks***.

  ➢ But large banks make loans ***in multiple MSAs***.

  ➢ The real economic conditions in MSA I will be affected by the closure/forbearance of banks headquartered in MSAs j≠i.

- This measurement error that may bias the estimated coefficients.

- May be able to use the FDIC Summary of Deposits data to (imperfectly) mitigate this problem.

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