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## Bank recapitalisation versus firm support: A fiscal criterion for crisis policy

Markus Haavio, Antti Ripatti, Tuomas Takalo / 18 Dec 2025

Governments routinely invest in private firms. This column argues that these investments have powerful effects on an economy's crisis resilience, and that those effects depend crucially on whether the government injects capital into financial or nonfinancial firms. If the economy's fiscal capacity is limited, recapitalising banks delivers more resilience per euro. If it allows large-scale risk absorption, direct firm support achieves similar stabilisation with fewer incentive distortions in banking.

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Governments often provide capital and other direct funding to banks and nonfinancial firms during economic crises. Government recapitalisation of banks was used in most of the 151 systemic banking crises between 1970 and 2017, with an average fiscal cost of around 8% of GDP (Laeven and Valencia 2020 and authors' calculations). During the Great Recession, the Federal Reserve and the US Treasury injected capital and direct funding into both banks and non-financial firms, with the sizes of bank and non-bank financing programmes reaching close to 5% and 3% of GDP, respectively (SIGTARP 2014, Labonte 2016). During the COVID crisis, public financial support was allocated predominantly to nonfinancial firms, with funding programmes reaching close to 15% of GDP in the EU and the U.S (Bruno et al. 2021, Haavio et al. 2025). Banks were also supported – for example, public loan guarantees, while targeted at firms in the real sector, de facto consist of a form of bank support (Bruno et al. 2021, Järvenpää et al. 2025). Governments also invest in private companies in more normal

times – for example, the US government has invested \$10 billion in 2025 in minority stakes in firms operating in steel, critical minerals, nuclear energy, and semiconductors (Swanson 2025).

## Crisis resilience versus incentive distortions

Whatever the motivations behind these government interventions in the balance sheets of private companies, their macroeconomic implications are profound. In our recent research (Haavio et al. 2025), we investigate the effects of government investments in private firms on the ability of an economy to sustain adverse shocks. We find a trade-off: public investments improve an economy’s crisis resilience, but also create incentive distortions that may weaken the economy’s long-run performance. Banks play a special role: they intermediate finance, screen and monitor borrowers, and operate with high leverage, which makes bank capital relatively scarce (Holmström and Tirole 1997). Thus, one euro injected into bank equity typically relaxes financing constraints by more than one euro injected directly into firms, which makes bank recapitalisation a powerful stabilisation tool. But there is a downside: public ownership dilutes private incentives. Because bank capital is scarce and levered, injecting public funds into banks crowds out more private incentives than the same injection into nonfinancial firms. As a result, bank recapitalisation delivers strong short-term stabilisation, but at a higher incentive cost.

Putting these forces together yields a simple size-contingent policy rule: small and medium-sized intervention programmes should target banks; large programmes should target firms. When programmes are small, one euro placed in banks buys more resilience than one euro placed with firms, because thicker bank equity both absorbs losses and reduces leverage. But as programmes grow, this advantage shrinks. Once the state already absorbs a large share of banking-sector risk, additional bank equity adds relatively little resilience, while incentive distortions grow rapidly. At that point, direct firm support becomes the more efficient stabilisation tool. Through such direct firm support, pressure on banks is also relieved with less dilution of incentives.

Our baseline calibrations suggest that larger programmes – when the government takes over more than 50% of aggregate private-sector risk – should support the real sector, whereas smaller programmes should target banks. As also shown by Table 1, public support of private companies, irrespective of the sector where they operate, can lead to sizable gains (even on the order of a 4.7% improvement in welfare) in a severe economic crisis, whereas in more normal times, such government interventions are likely to reduce welfare.

**Table 1** Welfare improvements from government investments in private firms

	Small programme		Large programme	
	Banks	Firms	Banks	Firms
Small shock	0.11%	-0.02%	-1.62%	-0.06%
Large shock	1.90%	1.77%	3.14%	4.70%

**Notes:** The numbers result from a calibration where a large (small) programme takes 80% (20%) of the macro risk from the private sector and a large (small) shock increases corporate bankruptcies by 60% (10%).

**Source:** Adapted from Haavio et al. (2025).

## Saving Wall Street or Main Street?

Governments have been unwinding COVID-era support, while expanding strategic investments in energy, defence, and technology. In doing so, policymakers should also think about the crisis-resilience of their economies and recalibrate prudential buffers. Our analysis suggests that public support of private companies is vital in a severe economic crisis. But if the state absorbs some private macro risk in such an economic crisis, where should that risk ultimately sit – on bank balance sheets or directly with non-financial firms?

Timely bank recapitalisations can avoid credit crunches and shorten recessions (Homar and van Wijnbergen 2017, Subrahmanyam et al. 2021). According to our research, aggregate shocks hit leveraged banks harder than they hit limited-liability firms. Since bank capital is a key channel of shock propagation in the economy, there is a case for supporting banks. On the other hand, government ownership dilutes incentives at banks to perform vital screening and monitoring activities. Weakened bank incentives to intermediate finance efficiently may hamper the reallocation process and lead to zombification and weaker credit quality in the long run (Bruno et al. 2021, Franco and Demmou 2021). Our results offer a practical rule of thumb. If fiscal capacity is limited, recapitalise banks; if fiscal capacity is large, support firms directly. Small programmes are most effective through bank equity or hybrid capital. Large programmes are better implemented through firm-side lending or equity-like instruments, which achieve comparable stabilisation with fewer distortions to banks’ core intermediation function.

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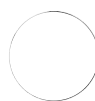
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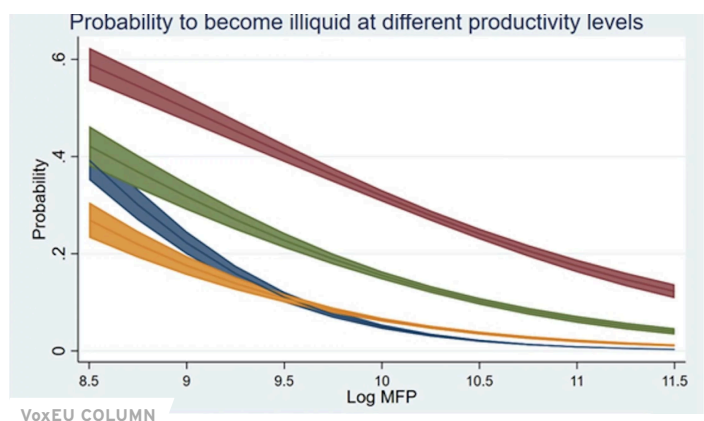
**KEYWORDS**

BANK RECAPITALISATION    CRISIS POLICY RESPONSE  
CRISIS INTERVENTION

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	Option 0: Basic option	Option 1: Forbearance of bank regulation	Option 2: Re-capitalisation via public money	Option 3: De-risking via asset sales	Option 4: Asset separation through an individual national bad bank model	Option 5: Asset separation through an EU-wide bad bank model	Option 6: Loss cap through restructuring conversion
Effectiveness	Green	Red	Green	Red	Green	Green	Green
Feasibility	Yellow	Green	Yellow	Green	Yellow	Yellow	Yellow
Credibility of policy	Green	Red	Green	Red	Green	Green	Green
Alignment of private players	Green	Red	Yellow	Yellow	Green	Green	Green
Structural impact at bank	Green	Red	Green	Green	Yellow	Green	Yellow

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