

Everybody hurts: Banking Crises and Individual Wellbeing^{*}

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Abstract: We investigate whether banking crises affect individuals' subjective wellbeing (SWB) in eighteen European countries between 1980-2011. We address the potential endogeneity of banking crises by exploiting spatial and temporal differences in banking crises episodes. We find negative, robust, pronounced and highly persistent effects for events prior to 2007. The 2007-2008 crash lowered SWB in countries that had previously experienced a credit boom. Individuals living in regions hosting financial centres suffer bigger losses. These effects extend beyond changes in macroeconomic factors, wealth and fiscal policies: they are hidden psychological costs. We suggest these may reflect an increase in Knightian uncertainty.

Keywords: Well-being; Happiness; Financial Crises; Banking Crises; Difference-in-differences, Uncertainty.

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1. Introduction

Economists generally agree that the ultimate goal of economic policy is to maximise the population's welfare. Welfare can be measured by the quantity and quality of goods and services that people enjoy, which are particularly related to income, wealth and job status changes. A financial crisis can shock this economic welfare system by imposing considerable burdens both on economies and individuals. There is an extensive literature on the channels through which these crises impact the real economy via credit disruption, wealth and output losses (e.g., Bernanke, 1983; Cecchetti *et al.*, 2009).¹

When compared to all other types of financial crises, banking crises are distinctive in that they independently affect the whole economic system and have both direct and indirect impacts on individuals. In addition to traditional economics' transmission mechanisms, there are more subtle transmission channels, an important one of which is the erosion of the fundamental trust that the entire financial system is built upon and the deterioration of the confidence necessary for investment and consumption (Zingales, 2011), banking crises, therefore, generally increase the overall level of uncertainty (Dow, 2012). Deaton (2011) and Askitas and Zimmermann (2011) suggest that the 2008 financial crisis was the driver of a general decline in mental health as measured by subjective well-being (SWB hereafter).

In this paper, our investigation of the effects of banking crises on SWB uses a larger cross-country dataset over a longer time period than that used by previous researchers. Typically, SWB data comes from longitudinal or cross-country surveys in which respondents are asked to evaluate their life overall or their happiness on a given scale.² In studies conducted by psychologists, sociologists and economists, SWB is typically found to be correlated with micro and macro-economic factors (e.g., income, job status, unemployment rate) in a predictable fashion (for reviews see Frey and Stutzer, 2002; MacKerron, 2012).³ The conclusions of Di Tella *et al.* (2001 and 2003) are particularly relevant to us; they were the first to show a negative association between recessions and SWB across Europe.

¹ In addition to this, economic downturns and other pronounced financial events have been found to have long-lasting economic consequences. For instance, corporate managers born during the U.S. Great Depression of the 1930s are less likely to use external financing (Malmendier and Tate, 2005), high leverage (Graham and Narasimham, 2004) and are more risk averse (Malmendier and Nagel, 2011).

² SWB, happiness and life satisfaction are used interchangeably in the remainder of the paper.

³ SWB data contributed to moving forward the empirical study of interdependence of preferences that can be traced back to Veblen (1899) and Duesenberry (1949). Happiness is relative because individuals tend to compare their present and past incomes; they adapt to new and higher levels of income and update their aspirations (e.g., Stutzer, 2004); and they compare themselves to their peers – deriving disutility from other people's income (e.g., Luttmer, 2005; Card *et al.*, 2012).

Conclusions from this paper help bridge the gap in research on the costs of banking crises and that on SWB by estimating these costs in terms of loss of life satisfaction using European data. We address the potential endogeneity of banking crises and study their persistence in the economy. We require, therefore, (a) a definition of banking crises that can discriminate between crises that impact the population as a whole (not just shareholders or big investors), and (b) a clear identification of the effects of banking crises.

Defining a variable that fully captures the intensity of banking crises is a problematic task. Such crises are complex events and proxies might be imperfectly correlated with the crises themselves (see e.g., Barrell *et al.*, 2010a).⁴ The literature on financial stability and costs of banking crises has resolved this issue by constructing event dummies based on several criteria that vary slightly according to the study. Establishing our own definition goes beyond the scope of this paper, therefore, we adopt this approach and utilize the databases compiled by Bordo *et al.* (2001), Caprio and Klingebiel (1996, 2003), Jonung and Hagberg (2002), Kaminsky and Reinhart (1999), and recently updated by Reinhart and Rogoff (2011). Although different definitions of a banking crisis are adopted in these databases, there is substantial agreement among these definitions regarding the episodes that occurred during our period of interest across Europe. We focus our attention on crises where commercial banks were involved, hence, excluding those events in which merchant banks only are involved. We do this because the outcome variable is the well-being of the whole population rather than some macroeconomic or financial outcome.⁵

We then match this data to individual SWB data from the Eurobarometer surveys covering eighteen European countries for the period 1980-2011. Our final dataset includes seventeen episodes of banking crises that can be categorized as borderline systemic crises. Five of these occurred before the 2007-2008 financial crisis in different countries at different times.

We start the analysis by running OLS regressions of individual SWB on banking crises controlling for country and year fixed effects (and typical micro and macro variables). The coefficient on the banking crisis can be interpreted causally only under the assumption of

⁴ Section 4.2 provides a detailed explanation.

⁵ It is worth noting that macroeconomic conditions have an impact on the individuals' SWB, particularly, but not exclusively, if these conditions are determinants of change in job status. Inflation and unemployment rate are often found to be negatively related to individual life satisfaction, even after controlling for individual characteristics (see e.g., Blanchflower *et al.*, 2014; Di Tella *et al.*, 2001 and 2003; Wolfers, 2003;). In our empirical specification, we do control for such a scenario; nevertheless our focus is on effects that go above and beyond these standard macroeconomic channels.

unconfoundedness.⁶ Establishing causality between macroeconomic events and well-being (both subjective and objective) is challenging. In this particular case, financial crises might be endogenous to SWB, because of simultaneous and omitted factors that could be correlated with SWB and the year of the crisis. Therefore, even when using a large array of micro and macro controls, OLS happiness regressions potentially result in biased coefficients. In order to improve upon this, we take advantage of the spatial and temporal variation of crises in our European dataset. This approach can be thought of as a (dynamic) difference-in-differences (henceforth DD) strategy. Specifically, we compare the SWB of individuals living in European countries before and after a banking crisis (i.e., multiple treatment groups), with individuals living in countries that, in the same period, do not experience a banking crisis (i.e., multiple control groups). The identifying assumption is that the SWB of individuals living in countries that did not experience a crisis form a valid counterfactual for the SWB of individuals living in treatment countries (after conditioning on micro and macro characteristics, country and year fixed effects). We check this assumption by allowing for leads and lags of the banking crisis effects. Statistically similar trends *before* the crisis suggest the absence of differential trends between treatment and control groups prior to the crisis.⁷

Our results can be summarised as follows. First, we show that OLS and dynamic DD estimates are very similar in most cases. If anything, DD estimates show slightly larger coefficients suggesting that OLS estimates might be downward-biased.

Second, banking crises, in general, have a negative and statistically significant effect on the SWB of Europeans; however, we are able to establish causality for the episodes prior to the 2007 and 2008 financial crash and SWB. For these events, we show that the psychological losses are highly persistent –lasting about four years from the onset of the crisis. These losses not only extend beyond the conventional macroeconomic controls (GDP, unemployment and inflation rates), but also beyond wealth losses and fiscal cost which might be associated with a banking crisis resolution. The estimated parameters are also relatively large. The loss in SWB brought about by the crisis during the first year is equivalent to an increase in the unemployment rate of ten percentage points. This may seem large, but because we are controlling for job status, the coefficient on the unemployment rate is likely to capture additional factors, such as the fear of being unemployed, rather than actual unemployment *per se* (see e.g., Di Tella et al., 2001; Blanchflower, 1991; Blanchflower and Shadforth, 2009).

⁶ This is also known as ignorability where the selection is based on an observable or conditional independence assumption (see e.g., Imbens, 2004).

⁷ For simplicity we will refer to this as dynamic DD estimates in the remainder of the paper.

We also compute the trade-off between income and the banking crisis that will leave people, on average, with the same level of SWB. We estimate that during the first year of the banking crisis, individuals would require an increase in income equivalent to moving from the first to the second income quartile to offset the decline in SWB.

Third, , although we estimate a negative coefficient for the 2007-8 crash, this is not statistically significant at the usual level of confidence. One explanation is that the episode was so severe and complex that it involved every country in our sample including the ones that technically did not suffer from a banking crisis. The data seem to support this hypothesis. We uncover two important facts related to the great recession: a) utilizing a triple DD we shows that the loss in SWB is sizeable for those countries that had previously experienced a credit boom and b) by means of an event study, we document that for the majority of the countries there is a negative trend in SWB starting about three years before the crisis.

Fourth, we study whether banking crises impact more heavily on some socio-economic groups. We do this by interacting banking crisis indicators with individuals' socio-economic characteristics. Overall, the results suggest that banking crises do not appear to have a different impact across groups. When the difference is statistically significant, the impact is not persistent over time.

Fifth, we find that banking crisis episodes hurt more individuals living in regions which host financial centres than statistically comparable individuals living in the rest of the country. This holds for the latest financial crisis too.

We interpret the decline in SWB as hidden costs associated with individuals' psychological distress caused by increased uncertainty and lack of trust brought about by the disruption of the banking systems. This interpretation would be mistaken (and the effect biased) if our DD estimator picks up concomitant events at the country-year level. We think this is unlikely as every specification controls for a variety of time-varying factors at the country level. However, the interpretation is also confirmed by a falsification test, in which an indicator of recession (years of negative growth in this case) instead of banking crisis as treatment, does not yield similar results.

The remainder of the paper is structured as follows. Section 2 highlights the previous literature on the costs of financial, especially banking crises, and the channels through which banking crises impact well-being. Section 3 highlights the empirical strategy. Section 4 focuses on the data sets. Section 5 contains the results and in Section 6 we offer our conclusions.

2. The costs of banking crises

Extensive research has been carried out to investigate the channels through which financial crises, and in particular banking crises, propagate through to the real economy. Hutchison and Noy (2005), for example, argue that banking crises may have adverse effects on economic output by disrupting the process of credit intermediation; this disruption imposes both direct and indirect costs on the economy as a whole or on parts of it. Cerra and Saxena (2008), employing panel data from 190 countries, find strong evidence of a large reduction in economic output. Similar evidence is provided by Cecchetti *et al.* (2009); looking at 40 crises since 1980, their results show sharp and persistent contractions in output. Hoggarth *et al.* (2002) suggest that output loss is about 15-20% of annual GDP, on average. More recently, Reinhart and Rogoff (2009a; 2009b and 2011), using a sample that spans centuries and several countries, show that banking crises have a long-lasting effect on both real economic activity and asset prices. Notably, unemployment rises, on average, for five years with an average rate of seven percentage points. Real GDP per capita falls by an average of about nine per cent, and the duration of the economic downturn is two years. Housing and equity markets are severely hit; the decline is about 35% and 56%, respectively. Barrell *et al.* (2006) show that banking crises have a non-negligible effect on consumption, particularly in the presence of high leverage.

The recent availability of richer longitudinal household surveys has prompted researchers to attempt to quantify the microeconomic costs of financial crises. Particular emphasis has been placed on the consequence of the recent financial crisis. Bricker *et al.* (2011) conclude that 60% of U.S. households experienced a decline in wealth between 2007 and 2009, and that about 25% of them lost more than half of their wealth. Chakrabarti *et al.* (2011) and Hurd and Rohwedder (2010) show how these losses have affected large numbers of households across all age, income, and education brackets. Bosworth and Smart (2009) calculate that this loss was about 20% for households aged over 50. Financial losses were associated with reductions in consumption, and many households reduced consumption even without experiencing financial losses (e.g. Christelis *et al.*, 2009; Shapiro, 2010).

In addition to these conventional welfare losses discussed in the macroeconomic literature, financial crises and economic recessions in general, impose costs that are more difficult to measure but nevertheless important. These intangible, hidden economic disruptions are linked to a decrease in individuals' mental well-being resulting from increased uncertainty, fear of

becoming unemployed and a decline in trust of the economic system (Deaton, 2011).⁸ Gathergood (2012), using longitudinal data from the UK, finds that problems with mortgage debt affect individuals' mental well-being.

Banking crises strongly affect the mutual level of confidence and trust between firms, households and banks. Any lack of confidence created by financial crises generates a higher system's uncertainty which will ultimately have a negatively impact the level of consumption and investment and more generally on individuals' well-being. The importance of uncertainty in the economic system cannot be over-emphasized; uncertainty is intrinsic to every transaction.⁹ A banking crisis involves a deep failure of trust and an increase in uncertainty: uncertainty about the borrower ability to repay the lender; uncertainty that commercial banks be able to provide liquidity on demand; uncertainty that the central bank will provide all the liquidity necessary to the commercial banks once it has set the interest rate; and uncertainty about the long term consequences of government finances. Related to this, Zingales (2011) shows a strong relation between the trust that respondents place on banks and their willingness to keep savings in the form of bank deposits.

The next section provides details on how this paper estimates these well-being losses using individual SWB data.

3. Empirical Strategy

In this paper, we estimate the effects of banking crises on SWB across European countries. The central feature of the methodology employed is the use of individual-level data (repeated cross-section surveys) to compare the experience of individuals that live in countries hit by a banking crisis to a similar but unaffected group.

The (indirect) well-being function (W) can be described as:

$$W = f(\mathbf{Z}, \mathbf{X}) \quad (1)$$

where \mathbf{Z} is a set of demographic and personal characteristics, including income, and \mathbf{X} is a set of macroeconomic controls to account for country-specific, time-varying factors (e.g., generic

⁸ Conversely, bad times seem to improve physical health (see for a review Rhum, 2006)

⁹ In support of this notion, the data show that bank deposits in the UK make up more than 90 per cent of all money used in the economy. A reliance on mutual trust may well be the best mechanism to deal with this unquantifiable level of risk. "In a crisis situation, uncertainty increases as the range of possible outcomes increases and as awareness increases of the extent of potential 'unknown unknowns' which cannot feasibly be incorporated into calculations." (Dow, 2012, p. 3).

business cycle influences).

The *happiness economics* literature estimates functions like W directly by employing subjective well-being data (e.g., life satisfaction or happiness scores) as a proxy for W . This approach has been used extensively in economics in recent years. It has been applied successfully in the study of attributes linked to (experience) utility and in the assessment of psychological losses and gains associated with socio-demographic and economic characteristics over time and across countries (e.g., Blanchflower and Oswald, 2004; Di Tella and MacCulloch, 2006). According to this framework, a well-being function such as equation (1) can be estimated by regressing individual scores of SWB on a variety of individual, economic, demographic and social variables. The implicit assumption is that self-reported happiness is a good proxy for underlying true well-being, experience utility or mental health. A number of studies support the use of SWB; self-reported happiness or life satisfaction strongly correlates with life events, physical measures and objective circumstances in a predictable way.¹⁰ We find this approach very convincing as indicated by the consistency of findings across different datasets and different countries.¹¹

Some studies examine the relationship between macroeconomic events and individual SWB. The seminal papers by Di Tella *et al.* (2001 and 2003), for example, show that SWB decreases when the unemployment rate and inflation increase (see also Welsch, 2010 and Blanchflower *et al.*, 2014).¹² This research unequivocally shows contemporaneous movements of SWB with macroeconomic measures, but, so far, has not successfully identified clear causal links.

One of the contributions of our paper is a simple framework to establish causality between macroeconomic events and SWB. The (average) effects of a banking crisis can be written in terms of potential outcomes and treatment effects as follows:

¹⁰ For example, happiness or life satisfaction are associated with the duration of an authentic smile, which involves involuntary contraction of the muscles surrounding the eyeball (the so-called “Duchenne smile” Eckman *et al.*, 1990), blood pressure and heart rate (Blanchflower and Oswald, 2008a), prefrontal brain activity (e.g., Davidson, 2004) and disability (Oswald and Powdthavee, 2008).

¹¹ There is a vast literature studying a variety of determinants of SWB in countries such as USA, Germany, Britain, Australia, Japan, Korea, South Africa, and most recently China. Regional and Worldwide surveys also exist (Eurobarometer Surveys, European Social Surveys, Latinobarometer Surveys, Gallup World Poll and World Values Surveys to cite the most common). Life satisfaction is typically found to be positively correlated with income – however, the relationship is curvilinear with richer individuals deriving less happiness than poorer individuals (e.g., Clark *et al.*, 2008a) even within twins (Li *et al.*, 2013). Being unemployed decreases SWB (e.g., Winkelmann and Winkelmann, 1998; Daly and Delaney, 2011), while being married is positively associated with it (e.g. Blanchflower and Oswald, 2004). Across a variety of datasets, SWB is also found to be U-shaped with respect to age (see e.g., Blanchflower and Oswald, 2008b; Wunder *et al.*, 2013).

¹² Wolfers (2003) found that volatility, and therefore macroeconomic uncertainty, plays a role too. Unemployment volatility has a pronounced impact on well-being; interestingly, the effects of inflation volatility on well-being are less evident.

$$\xi(D = 1, J = 1) = E[W^1 | D = 1, J = 1, \mathbf{Z}, \mathbf{X}] - [W^0 | D = 1, J = 1, \mathbf{Z}, \mathbf{X}]. \quad (2)$$

W^1 and W^0 are potential well-being outcomes with and without the banking crisis, respectively. The banking crisis is identified by D and J , binary crisis-year and country indicators, respectively. The term $\xi(D = 1, J = 1)$ represents the average treatment effect on the treated, i.e., the mean of these treatments effects across those individuals living in country J after a crisis hit. \mathbf{Z} and \mathbf{X} are defined as above. The effect of the crisis can then be estimated by running SWB regressions on the country-year of the crisis. Implementation of this method is complicated by the presence of simultaneous or omitted factors at country-year level that are not observed by the researcher but do correlate with the year of the crisis. The specifications we use in this paper include (a) typical OLS happiness regressions on banking crises and (b) a dynamic DD estimator. In what follows, we briefly review the econometric theory behind each of these approaches. The analysis will then study whether these psychological costs extend beyond economic losses typically associated with financial crises (e.g., income, job status, wealth). Furthermore, we compare banking crises to more general economic crises; this will serve to establish whether the effects arise from banking crises rather than from general economic downturns. Finally, we investigate the impact of crises on different socio-demographic groups and, for the latest crisis, on countries that experience a credit boom.

Following Ferrer-i-Carbonell and Frijters (2004), and more generally Angrist and Pischke (2008), we estimate all our regressions using linear probability models.¹³ In all specifications, we correct the standard errors using the two-way approach of Cameron *et al.* (2011) to account for correlation within country and year levels. We also estimated standard errors by clustering at country level as suggested by Bertrand *et al.* (2004). The two methods yield similar standard errors.¹⁴

3.1 The Basic Model

We first investigate the relationship between SWB and banking crises using different specifications of conventional happiness regressions prior to establishing causality using a difference-in-differences framework. The baseline equation at the individual level is given by

¹³ Angrist and Pischke (2008) show that the linear probability model is the best (linear) approximation for non-linear conditional expectation functions, whereas Ferrer-i-Carbonell and Frijters (2004) demonstrate that the ordinal nature of happiness scores can be studied by using OLS with empirical examples.

¹⁴ Results are available upon request.

$$SWB_{ijt} = \lambda_t + \alpha_j + \mathbf{X}_{jt}\boldsymbol{\beta} + \mathbf{Z}_{ijt}\boldsymbol{\gamma} + \xi D_{jt} + \epsilon_{ijt} \quad (3)$$

where i indexes individuals, j indexes nations, and t indexes time. λ_t and α_j are the year effects and the country fixed effects, respectively. D_{jt} is a dummy variable which takes the value of 1 for the year of a banking crisis and 0 otherwise, \mathbf{Z}_{ijt} are individual-specific covariates, while \mathbf{X}_{jt} accounts for macroeconomic variables that control for time-varying general characteristics at a country level.

In this specification, the effect of a banking crisis is measured by the coefficient ξ . This parameter equates to the average treatment effect only under the assumptions of unconfoundedness (i.e., there are enough controls so that the banking crisis assignment is essentially randomised). A specific problem here is that the banking crisis might be correlated with ϵ_{ijt} because of either omitted or simultaneous factors being correlated with both the timing of the banking crisis and life satisfaction at country-year level; for example, banking crises may occur in countries that are affected by higher or lower levels of optimism. Variables may be omitted from even the best dataset, especially at the macro level.

3.2 Difference-in-Differences Estimates

We now take into account the potential endogeneity bias arising when running simple happiness regressions by adopting a dynamic DD framework. The starting point of this approach is common to the model in equation (2): other things being equal, one would expect that individuals living in a country hit by a financial shock in year t (i.e., treatment group) are more affected than a comparable group of individuals living elsewhere after year t , i.e., after the banking crisis occurred. The identifying assumption is that variations in SWB between treatment and control groups would have the same trend after the banking crisis, if the banking crisis did not occur. In a DD setting, this is usually known as the common trend assumption and cannot be verified. However, a common trend in SWB between treatment and control groups *before* the banking crisis is satisfactory evidence to indicate that banking crises are indeed exogenous.¹⁵ A natural way to check for the applicability of the assumption is to allow for leads and lags of the treatment (i.e. the banking shock). The equation at the

¹⁵ The model is complicated by having multiple treatment groups and multiple periods (moreover, the same treatment group can receive the treatment more than once).

individual level is:

$$SWB_{ijt} = \lambda_t + \alpha_j + \mathbf{X}_{jt}\boldsymbol{\beta} + \mathbf{Z}_{ijt}\boldsymbol{\gamma} + \sum_{n=-m}^q \xi_n D_{jt}(t = q + n) + \epsilon_{ijt} \quad (4)$$

where i indexes individuals, j indexes nations, and t indexes time. λ_t and α_j are the year and country effects, respectively; ϵ_{ijt} is an individual specific error term. $\sum_{n=-m}^q \xi_n D_{jt}(t = q + n)$ is the term of interest, we allow for m leads and q lags of the treatment effect. ξ_n is the coefficient of interest on the n th lag or lead. ξ_0 is then the normalised year corresponding with the beginning of the crisis.

This dynamic DD specification is then similar to equation (3) but augmented by leads (anticipatory) effects and lag effects. This approach enhances the analysis in two ways: first, lagged effects relax the implicit assumption, common to standard DD estimators, of constant treatment effects. The dynamic DD allows us a) to look at whether individual SWB varies over time after the banking crisis and b) to study the persistence of, and adaptation to, these effects over multiple periods.¹⁶ Second, the battery of m leads provides evidence of the common trend assumption. If the controls and treatment groups are correctly separated, we would expect that all the coefficients leading to the introduction of the treatment are not statistically different from zero, $\beta_n = 0, n < 0$. If the anticipatory effects are different from zero, then the future treatment would predict current outcomes, suggesting that banking crises may not be exogenous. Because there is one crisis every five years roughly, we present the results using four leads and lags when using the 1980-2003 sample (i.e., every year from ξ_{-4} through ξ_{+4}). For the 2003-2011 sample, we adopt a model which uses every year from ξ_{-4} to ξ_{+2} . In the last case, the reference category is the third and/or fourth lag (ξ_{+3} and ξ_{+4} , i.e., either 2010 or 2011).

¹⁶ It is well known that one's happiness shocks are temporary, lasting few years, after which adaptation is mostly completed in a variety of cases, including changes in income (Di Tella *et al.*, 2010 and Gardner and Oswald, 2007), and changes in status, e.g., disability (Oswald and Powdthavee, 2008), marriage and divorce (e.g., Clark *et al.*, 2008b and Frijters *et al.*, 2011).

4 Data

4.1 Life satisfaction and individual characteristics

Our main data source is the Eurobarometer Survey Series, a repeated cross-section survey in which a random sample of Europeans are asked a series of demographic and socio-economic questions, including one on life satisfaction. These are conducted twice a year on average and each survey consist of approximately 1,000 face-to-face interviews per country.¹⁷ These interviews take place between March and October each year. Our sample covers the period 1980 to 2011. The main question of interest is: “On the whole, are you very satisfied, fairly satisfied, not very satisfied or not at all satisfied with the life you lead?” Answers to the question can be split into four categories.

In this paper, we use samples of individuals living in eighteen European countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, United Kingdom, Switzerland and Iceland.¹⁸

We consider four different samples by including or excluding the latest banking crisis (i.e., the 2007-2008 financial crash). The first sample includes all individuals interviewed between 1980 and 2003; this gives us 633,687 observations. We are interested in studying the effect of including and excluding income on our treatment effects since the income variable is dropped from the Eurobarometer surveys after 2003, but understanding the impact of income on the treatments’ SWB is important. Thus when personal income is included in the specification, the number reduces to 459,799; this is the second sample. The third sample includes 315,877 observations from interviews after 2003 to 2011, i.e., just before and during the current financial crisis.¹⁹ Finally, our fourth sample includes all individuals who participated in the surveys from 1980 to 2011 (including the individuals who did not report income during all periods considered); this sample size is 933,943.

The use of separate samples is beneficial: for instance, excluding the latest banking crisis from some of the analyses is necessary as the effect of the banking crisis may be confused

¹⁷ http://ec.europa.eu/public_opinion/archives/eb_arch_en.htm.

¹⁸ Questions are not systematically asked in all countries each year, hence, technically this is an unbalanced panel of countries. Data for Germany are included post unification. In particular, we have the following years of data by country: Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, UK (1980-2011); Germany (1992-2011) Austria, Finland, Sweden (1996-2011); Greece (1981-2011); Portugal, Spain (1986- 2011); Norway (1991-1993, 2001 and 2005); Iceland (2005, 2010-2011); Switzerland (2005) .

¹⁹ The year 2003 is included in each of these three samples. Its exclusion does not affect the results.

with other macroeconomic shocks.²⁰

In summary, we have four sample period that we will use for the analyses: 1) the period 1980-2003, which includes individuals who reported their income; 2) the period 1980-2003 in which individual's income is excluded; 3) the period 2003-2011 (i.e., just before and after the 2007-2008 financial crisis); 4) the whole period 1980-2011.

Every regression includes a set of individual characteristics typically used in the literature: age, age-squared, dummy variables indicating gender, marital status (married, single, divorced or separated, widowed), educational attainment (i.e., age-left-school dummies), work status (employed, self-employed, unemployed), and whether retired, keeping house or a student.

4.2 Banking crises

The financial literature does not provide a single definition of a banking crisis. As explained in Barrell *et al.* (2010a, p. 3) “The problem lies in the fact that a banking crisis is an event, so proxies for banking crises would not necessarily be perfectly correlated with banking crises themselves”. If a quantitative candidate variable is found, it is usually not unique, is highly inconsistent and involves a degree of subjectivity (Kaminsky and Reinhart, 1999; Demirguc-Kunt and Detragiache, 1998). More specifically, banking problems can stem both from the liabilities and the assets sides of the banks' balance sheets. In the former case, a measure for banking insolvency could be a good proxy; thus, even though a government intervention or deposit insurance schemes could prevent the crisis, the threshold could still be violated. However, when crises arise from banks' assets, for instance, problems in asset quality eroding banking capital, a unique proxy would not pick up all the events across countries and across time.

For this reason, several different databases compiled on the basis of various criteria, can be found in the financial literature.²¹ The two most recent and popular databases used are those of Reinhart and Rogoff (2011) and Leaven and Valencia (2012). Reinhart and Rogoff (2011) collected and updated data from a variety of sources, such as Caprio and Klingebiel

²⁰ The Great Recession was initiated by a housing and banking crisis in the USA but it later developed into a sovereign debt crisis in Southern Europe.

²¹ For instance, Caprio and Klingebiel (1996) define a systemic crisis as an event when “all or most of the banking capital is exhausted”; their final database includes 93 countries. Kaminsky and Reinhart (1999) identified 26 systemic banking crises over 20 countries during the period 1970-1995. The criteria adopted are similar to Demirguc-Kunt and Detragiache (1998); a crisis is recorded if one of the following criteria is met: i) the ratio of nonperforming assets to total assets in the banking system exceeds 10 per cent; ii) the cost of the rescue operation is at least 2 per cent of GDP; iii) large scale nationalisation of banks; and iv) extensive bank runs or emergency measures were implemented by the Government in response to the banking crisis.

(1996, 2003) and Kaminsky and Reinhart (1999).²² Following Reinhart and Rogoff (2011, p. 1680), a banking crisis is marked “by two types of events: (1) bank runs that lead to the closure, merging, or takeover by the public sector of one or more financial institutions [...]; and (2) if there are no runs, the closure, merging, takeover, or large-scale government assistance of an important financial institution (or group of institutions) that marks the start of a string of similar outcomes for other financial institutions [...]” This definition is very similar to the one used by Leaven and Valencia (2012, p. 4), who define a banking crisis “as systemic if two conditions are met: 1) significant signs of financial distress in the banking system (as indicated by significant bank runs, losses in the banking system, and/or bank liquidations); 2) significant banking policy intervention measures in response to significant losses in the banking system.”

Although this latter definition is very close to that of Reinhart and Rogoff (2011), it is far more restrictive since it excludes near-systemic crises, hence, there are very few episodes affecting our sample of countries. Moreover, there are several notable cases (Italy, 2008; Luxembourg, 2008; Sweden, 2008) wherein Leaven and Valencia (2012) report a crisis, whereas none are reported by Reinhart and Rogoff (2011). Furthermore, there is disagreement on the latest crisis for Ireland; Leaven and Valencia (2012), for example, date the start of the crisis in 2008 rather than 2007. In general, recent papers tend to agree with Reinhart and Rogoff (2011) (e.g., Borio and Drehmann, 2009).²³

Based on the discussion above, we adopt the dataset of Reinhart and Rogoff (2011), and references therein. Because our paper is a study of hidden costs for the whole population using SWB, a close examination of two “minor” 1984 and 1995 UK crises leads us to exclude these events, since they were related to merchant banks which hold no deposits from the general public.²⁴ Table A1 in the Appendix is drawn from Reinhart and Rogoff (2011) and describes every episode affecting our sample of 18 countries. A total of seventeen near-systemic banking crises were identified over the entire period.

The next step is to map these episodes in the Eurobarometer Surveys. Since these surveys are not run every year for every country in our sample, we cannot merge life satisfaction data with ξ_0 – the beginning of the crisis – for every episode. In particular, life satisfaction data

²² The dataset accompanying the Reinhart and Rogoff (2011) paper can be found at <http://www.aeaweb.org/articles.php?doi=10.1257/aer.101.5.1676>. The most recent updates of the database can be found here: <http://www.reinhartandrogoff.com/data/browse-by-topic/topics/7/>.

²³ Investigating the latest financial crisis, Borio and Drehmann (2009) provide further evidence that a banking crisis did not occur in either Italy or Sweden.

²⁴ Results do not change substantially when including these two UK crises.

are missing for the year of the crisis in five cases, namely, Finland (1991), Sweden (1991), Norway (1987), Iceland (2008) and Switzerland (2008). In all these cases, instead of dropping observations when running the dynamic DD model, we use information on life satisfaction data as leads or lags if the surveys were conducted in years leading up to or following the financial crisis. In particular, for Finland and Sweden, surveys are available only for year ξ_{+4} , while for Norway only for ξ_{+3} and ξ_{+4} . For Iceland, Eurobarometer surveys are available only for year ξ_{+3} and ξ_{+4} , and year ξ_{-2} , while for Switzerland, the only Eurobarometer survey was conducted 3 years before its crisis (ξ_{-3}). Table 1 provides a snapshot of the countries for which we are able to merge life satisfaction data with the year ξ_0 .

[TABLE 1 ABOUT HERE]

It is important to stress that crises vary in length, and, as reported in Cerra and Saxena (2008), the end of a crisis is never clearly defined. Our dynamic DD model is able to resolve this issue by estimating the immediate impact of the crisis as well as its persistence.²⁵

4.3 Macro controls

Our dataset comprises a set of macroeconomic variables typically used to control for time-varying country effects and, in general, business cycle fluctuations. Data for unemployment, GDP and inflation are collected from the World Bank's World Development Indicators (WDI). These data provide annual, PPP-adjusted per capita GDP figures. The PPP adjustments are based on the 2005 round of the International Comparisons Project, and all of our estimates are in 2005 international US dollars. When the WDI data are missing, we supplement them with data from the Penn World Tables and from the IMF World Economic Outlook.

Summary statistics of all the variables discussed in this Section can be found in Table 2.

[TABLE 2 ABOUT HERE]

²⁵ A similar approach, albeit in a time-series context and therefore without control groups, is adopted by Barrell *et al.* (2010b), who capture the long run impact of banking crises with dummies that take the value of 0 prior to the crisis and 1 from the time of the crisis onwards.

5 Results

5.1 Basic Regressions

We first investigate results from an OLS specification in which the effect of banking crises on SWB is estimated by regressing life satisfaction on a banking crisis dummy, and controlling for a set of micro and macro variables typically used in the literature (see equation (2)).²⁶

[TABLE 3 ABOUT HERE]

There are two main conclusions that can be made from Table 3. Firstly, the sign on the variable of interest is negative and statistically significant at the usual level of confidence, only for the sample covering the period before the latest banking crisis. The absence of a statistically significant coefficient for the latest crisis comes as unexpected and bears further investigation: there are various plausible explanations, such as the ‘non-exclusivity’ of the 2007-2008 financial crisis, i.e., the crisis was extremely severe and developed simultaneously in all European and overseas countries. In the next sections we will examine this further.

Overall, the results pre-2008 suggest a statistically-significant psychological cost associated with the year of the crisis itself. The first column in Table 3 indicates a stronger negative effect on well-being compared to the other columns. However, these columns are not fully comparable since the inclusion of income quartiles implies the (contemporaneous) exclusion of the latest crisis. This is due to the fact that surveys did not include income levels after 2003²⁷. If income losses are positively correlated with the banking crisis and SWB, then, the omission of income quartiles may lead to an overestimation of the effect of the banking crisis. However, the second column shows that the size of the banking crisis dummy is larger when income quartiles are controlled for (see the first column). Assuming that the same is true for the more recent financial event, a *happiness regression* estimation carried out without controlling for income quartiles – as we are forced to do due to data availability – represents a conservative estimate of the latest banking crisis.

²⁶ For simplicity, we do not report the estimates of our numerous control variables. They are in line with previous research. SWB is higher for female, married individuals and, among labour market status, for students; it is U-shaped in age; being unemployed is associated with lower SWB. Higher income groups report higher SWB. The macroeconomic variables have the usual sign, however they are not always statistically significant. These results are available upon request.

²⁷ The income variable was not collected also for the year 1995. Effectively, when controlling for income, one is excluding the Great Recession from the analysis.

5.2. The hidden cost of banking crises

The analysis indicates that there is a statistically significant correlation between SWB and the banking crisis, however it does not explicitly address the issue of causality. In order to resolve this we adopt a dynamic DD (see Section 3.2). Table 4 reports the estimated coefficients of such a model.

[TABLE 4 ABOUT HERE]

Various interesting facts emerge from Table 4. First, the coefficients on the banking dummy variables are not significantly different from zero for all years before the crisis (i.e., there are no anticipated effects), indicating similar trends in SWB prior to the banking crisis in treatment and comparison groups. This supports the identifying assumption of the dynamic DD model. There is no statistically significant difference in SWB before the event either in countries affected by the crisis or in those that are not affected. We take this as an indication that countries spared from the crisis represent a good counterfactual. In other words, banking crises are exogenous shocks with respect to SWB. This is also shown in Figure 1 in which estimated coefficients from Table 4 are graphically reported with 90% confidence level.²⁸

[FIGURE 1 ABOUT HERE]

Second, when we exclude the 2008 financial crisis, we find that banking crises have a statistically significant negative effect on the SWB of individuals across Europe: the magnitude of the coefficient ξ_0 , in absolute value, is 0.102 and significant at the 5% confidence level. When we exclude income quartiles its value falls to 0.086. This value is in agreement with the result in Table 3 and supports the notion that, when income is excluded, the estimates are more conservative. We then compare the negative coefficient of 0.1 in the first year of the crisis with the size of other coefficients in the same regression in order to put these findings into a broader context.²⁹ Thus, this loss in SWB is equivalent to an increase in the unemployment rate by ten percentage points. A move from the first to the second income quartile would be required to keep happiness constant during the year of the crisis. These

²⁸ For completeness, Table A2 in appendix shows the results when UK merchant bank crises are included in the sample (see Section 4.2).

²⁹ Estimated parameters for other coefficients are not shown but are available upon request.

examples clearly show that the coefficient is measuring a substantial loss in well-being.

Third, the SWB decline is identified after controlling for individual and macroeconomic conditions such as income, job status, GDP, unemployment and the inflation rate. This implies that there are non-negligible, non-conventional or hidden costs associated with the banking crisis. We discuss the mechanisms that may be responsible for these results in the next Section.

Fourth, the impact of a banking crisis is highly persistent and is at least twice the length of the average GDP drop identified in other studies that look at the effect of banking crisis and national income (e.g. Reinhart and Rogoff, 2009a and 2009b). This seems to indicate that banking crises have a deep psychological impact that persists even when GDP reverts to its initial level.

Fifth, when we examine the recent financial crisis, we note that the estimated banking crisis parameters are roughly half the size and are statistically insignificant. Although this sample corresponds to almost one third of the whole period (1980-2001), the same result is found when pooling all crises. One explanation for this result is that we simply have a confounding problem.

We think that there are two reasons for this. First, only four countries in our database did not have a banking crisis, Finland, Sweden, Italy and Luxembourg.³⁰ However, Italy and Luxembourg were indirectly affected by the crisis, while Finland experienced a different type of financial crisis – a crash of its stock market (see Reinhart and Rogoff, 2011). Luxembourg's economy, for example, is heavily reliant on the financial industry, since about one quarter of Gross Value Added (GVA) is generated by financial and insurance activities.³¹ Italy was hit by a debt crisis and banks were negatively affected by firms' and households' solvency and, consequently, had to raise additional cash.³² We interact the banking shock variables with the contribution of the financial system to the GVA in each country to analyse this situation.³³ Results are presented in Table A3 in appendix and show that there is no differential effect between countries with different financial sectors.

A second reason is that financial globalization and the introduction of the euro have led to

³⁰ Sweden and Norway are not hit by the banking crisis either, however, Eurobarometer surveys were not conducted in those years, so they are not included in the control group. See Table 1.

³¹ Data from Eurostat on the percentage of financial and insurance activities of the total GVA (at basic prices) for the years 2007, 2008, 2009 are 28.0%, 25.5%, 25.4%, respectively.

³² See Messori (2009).

³³ GVA data were collected from the EUROSTAT database.

the development of a highly interconnected banking industry.³⁴ Hence, we do not find a significant impact from the 2008 financial crash since all countries in our sample have been hit by financial or economic turmoil, from which banking crises are difficult to separate.

In other words, it is not possible to clearly identify a control group *after* the crisis. This is corroborated by the plot of the average SWB of treatment and control groups for the years around the latest crisis (see Figure A1 in the Appendix). Clearly, although statistically similar (see Table 3) there is less evidence of a common trend before the crisis; most importantly, the drop in SWB is of similar magnitude and occur around the same years. It is therefore instructive to focus the analysis of the latest financial crisis on a country by country basis. We do this in the next Section.

5.3. The 2007-2008 financial crash and SWB

In the previous sections we have showed that the estimates of the effect of the last financial crisis on individuals' SWB are negative but statistically insignificant; we have already discussed one possible explanation for this, which is there are confounding factors at macroeconomic level such as banking interconnectedness and sovereign debt crisis, that hinder the identification the effect of the banking crisis. In this section, firstly we provide a country by country analysis; then we expand our control group of countries and finally we then test further hypotheses by looking at differential impacts across countries (triple DD).

We start by looking at averages of SWB (Table A4) and then move onto running standard event studies at country level (Figure 2). Norway, Iceland and Switzerland have been excluded from the analysis because some of the key years are missing. The total countries analysed here is thus fifteen. Simple averages of life satisfaction for each year from 2003 onwards in the countries considered highlight the following patterns: a) there is a substantial decline in SWB starting in 2005 up to the onset of the crisis for all the countries considered (treated and control); b) the fall is larger between 2005 and the year preceding the crash (ξ_{-1} , either 2007 or 2008) than in the year of the crash (ξ_0) in more than 50% of the cases ; c) there is evidence of a strong and quick recovery in SWB in the vast majority of countries, which may be the result of adaptation.

Figure 2 presents event studies that provide us with a picture of the dynamic of the well-being in each country around the years of the latest crisis and helps us to deepen our

³⁴ Starting from the late 1990s, banks took advantage of cross-border openness to exploit economies of scale. See Claessens *et al.* (2010) and Allen *et al.* (2011) for a discussion.

understanding for the lack of a statistically significant difference between treated and control groups. The analysis focuses on 8 years, 4 years before and 3 years after the crisis. With regards to the countries forming the control group, we focus on the 8 years between 2004 to 2011. Each event study is a regression of individual SWB on personal, macro controls (inflation, unemployment and GDP) and year fixed effects. Each graph plots the value of the estimated year fixed effects (normalised with respect to the year of the banking crisis in the case of the treatment countries) and 90% confidence intervals. These largely confirm the descriptive analysis and add additional insights. First, there is a clear decreasing trend in wellbeing starting a few years before the banking crisis (in ξ_{-2} or ξ_{-3} ,) in the majority of countries (including countries forming the comparison group). Second, contrary to Table A4, and just by looking at the point estimates, the drop is more pronounced in year ξ_0 rather than in the previous years for six countries. Third, the negative effect in year ξ_0 is statistically significant at least 10% level for six countries (Greece, Ireland, Portugal, Austria, UK and Italy 2008) while it is the year just after the crisis which is statistically significantly negative in Spain. Fourth, there is no sign of persistence, but SWB fully adapts within at least two years with the exception of Greece, while Italy fully adapted by 2011. Finally, when looking at the whole 8-year period, the change in SWB is negative and statistically significant at 10% level for at least two consecutive years in one third of countries: Ireland (from 2006 to 2008), Austria (from 2005 to 2007), Portugal (2008 and 2010) and UK (from 2006-2008).

This country by country analysis is useful in that it clearly highlights how the period 2005-2008 has been generally characterised by a consistent drop in SWB in the sample of countries considered and that it is difficult to pin-point this to a single event, namely, in this case, the financial crisis. The evidence seems to suggest that other macro events, perhaps resulting from the European debt crisis, has had a bigger impact on individual SWB than the banking crisis itself. Investigating this is outside the scope of this paper; further research is needed to assess this aspect.

In order to improve our control group for the latest crisis, we have estimated DD models that include Central and Eastern European countries, some of which did not experience a banking crisis. However, the results do not change substantially as shown by Figure 3 which plots the coefficients of the corresponding regression. Including these countries in the 2007-8 sample reduces the size of each negative coefficient while at the same time improving their precision. As a consequence, the negative effect of the Great Recession is now statistically significant at 10% level for the year after its onset.

5.3.1. *The role of the credit boom*

The current financial crisis began during 2007-8 when financial stability replaced inflation as central banks' main concern. The roots of the crisis go back much further, and there are many views on the fundamental causes including imprudent mortgage lending, deregulatory legislation, credit default swaps, fragmented regulation, and lack of a systemic risk regulator. One of the most important and distinctive elements of the current crisis lies in the nature of the so-called credit cycle (Kindleberger, 1978 and Minsky, 1982). The term describes the tendency of the financial system to excessively increase its credit supply during the upswing and to strongly cut down lending during recessions (when everybody tries to evade risk). Several authors (e.g., Lindsey, 2007) have documented the similarities between the recent boom–bust pattern and earlier episodes. The implication in our context, is that when the credit flow halted, individuals living in countries that experienced a credit boom suffered a higher loss than countries where the credit market did not expand too rapidly. We proceed by defining a credit boom indicator as in the IMF Systemic Banking Crises Database of Laeven and Valencia (2012), which follows Dell’Ariccia *et al.* (2012).

[TABLE 5 ABOUT HERE]

The results are presented in Table 5. We find that the average loss in well-being is much more pronounced across those countries which experienced a credit boom, but only in year ξ_{+1} . This result is robust even after controlling for stock market returns and fiscal variables, such as the tax burden and government consumption. Across the four specifications of Table 12, the estimated coefficients of the latest banking event for the year after the crisis range between -0.110 and -0.131. Comparing this with the result pre-2003 presented in Table 4, column 2, this latest crisis has generated a loss in well-being that is higher than that of the previous banking crisis, but with a much less persistent effect.

Although the financial crisis was a widespread phenomenon the consequent recession seems to have had a severe impact on those countries that experienced a rapid increase in house prices and a following collapse of the market. We interact the shock variables with annual rate of growth of house prices in each country. Results reported clearly show that there are no such differential impacts across countries (Table 5).

5.4. Channels

We have shown that banking crises generate a loss of well-being that goes beyond that generated by individual characteristics and macroeconomic factors such as inflation, unemployment and GDP. We have also reported studies (Section 2) indicating a variety of other more indirect channels through which banking crises affect the individuals' SWB. In this section, we build upon that literature to shed extra light on what are the mechanisms at play.

Banking crises are complex financial situations that may result in overall financial and economic instability, hence, prompting governments to intervene directly. This intervention could have some tangible repercussions both on the overall economy and the individuals' SWB. For instance, direct intervention to rescue financial institutions could create fiscal constraints for a government that is bound by budgetary regulations. The result could be either a decrease in government expenditures and/or an increase in the tax burden. Moreover, if we accept the Ricardian equivalence postulate, households may contract their current consumption in the expectation of future increases in taxation. All these factors would have direct and indirect impacts on individual's income and ultimately on their welfare and well-being.³⁵

Beyond the *fiscal channel*, SWB may change via the *wealth channel*. One of the consequences of a banking crisis is turmoil in stock markets; Reinhart and Rogoff (2009b), for example, find that equity markets experience an average drop of 55%.³⁶ This sharp and prolonged decline is associated with a loss in wealth, both at the institutional level (e.g., pension funds) and the individual level (e.g., savings) and consequently, an individual's SWB.³⁷

This brings us to test the hypothesis of a link between banking crises and SWB that impact the individual via government intervention (consumption, level of taxation) and via a wealth effect (brought about by a decline in the stock market). We re-estimate equation (4), therefore, in order to include government consumption, tax level and stock market returns as additional controls; if one of these channels is verified we expect the banking crisis dummy indicator to become smaller and to lose statistical significance.³⁸

³⁵ Hessami (2010) presents evidence on the link between government expenditure and SWB. See also Di Tella and MacCulloch (2006)

³⁶ Later, within the context of the 2008 financial crisis, we also explore the wealth channels operating via the housing channel.

³⁷ An indirect wealth channel is also taken into account by controlling for inflation, in fact a higher inflation rate leads to a redistribution of wealth between borrowers and lenders.

³⁸ Government consumption and tax burdens are normalized by GDP. Total tax burden is estimated excluding imputed social

[TABLES 6 ABOUT HERE]

The results, presented in Tables 6 clearly indicate that even when these extra variables are included, the coefficients on the banking crisis episodes prior to 2007, remain negative, roughly of the same size, and statistically significant.³⁹

In light of these estimates and the evidence presented above, we suggest that there is a fundamental effect of banking crises that is not yet accounted for in our study.⁴⁰ This hidden effect could involve a deep failure of trust, such as trust in financial institutions or trust in political/regulatory institutions. This failure could also be a powerful determinant of Knightian uncertainty and have a non-negligible impact on an individuals' level of risk, stress and ultimately SWB.

5.5 Recessions vs banking crises: a falsification test

It is reasonable to assume that the (hidden) effect identified above is the result of deep economic recessions coinciding with a banking crisis. To test this, we create a “placebo” treatment in the form of a dummy variable that takes the value of one when the annual economic growth in each country is negative. Equation (4) is then re-estimated using the new treatment variable. Our hypothesis is that if the previous results are only guided by general economic downturns, then we should expect similar results to those presented in Table 4. If, instead, banking crises have distinct psychological costs, we should observe a different pattern.

[TABLE 7 ABOUT HERE]

Columns one to three in Table 7 account for all negative GDP growth years from 1980. Some important facts emerge; first, in all specifications, the years before the shock are not statistically significant, suggesting that there is no difference in SWB trends between treated and control groups. At the beginning of the recession the coefficient is significantly lower than the one reported in Table 4. The duration also appears to be different; if, in the case of a

security contributions and reported as a percentage of GDP at market prices using the excessive deficit procedure. We draw these data from the AMECO database of the European Commission. Data on stock markets is computed based on the share price index for each country as provided by the Reuters Thomson Datastream database.

³⁹ Furthermore, none of the additional control variables included are statistically significant.

⁴⁰ One may conjecture that SWB losses could be a consequence of a reduction in health. However reasonable this may appear, the bulk of the literature clearly shows that health actually improves when the macro economy worsens (for a recent review see Rhum (2006) or Adda *et al.*, (2009)).

banking crisis, we had a rather persistent effect, the negative shock evaporates after the end of the first year and turns positive with the third lag.

The evidence presented in this section is consistent with the presence of psychological distress caused by increased uncertainty brought about by the disruption of the banking systems and not by other economic crises.

5.6. Differences across socio-demographic groups

The above results indicate that, on average, banking crises have a long and lasting effect on the SWB of individuals across Europe in the pre-2007 years. A potential issue with pooled regressions presented above is that they might conceal a fair amount of heterogeneity in the elasticity groups of individuals. It is possible that financial and economic downturns have differential impacts on groups of individuals with specific characteristics, thus, we need to understand these distributional costs of a banking crisis. We focus our attention, therefore, on the degree of heterogeneity of the response of SWB to a banking crisis across socio-economic groups. We do this by interacting leads and lags with individuals' socio-economic characteristics. In particular, we study the effect of a crisis on marital status, gender, income quartiles (this can be done only for period 1980-2003) and labour market status. This provides us with a direct test of whether a banking crisis affects some groups more than others. This analysis could be especially interesting for the latest financial crisis because, even though never statistically significant, the sign on the latest financial crash is always negative, indicating perhaps that some categories of individuals may have been shielded from the harsher effects of the crisis.

[TABLES 8 ABOUT HERE]

Table 8 contains estimates for the early banking crises and for the most recent financial event, respectively. We run separate regressions for each set of social or demographic indicators; for instance, when studying heterogeneous effects across labour market status we run a regression in which the DD parameters are interacted with all labour market status indicators, but not with other variables. For clarity, the Tables show only the estimates of the triple interaction between leads, lags and the individual characteristic of interest. In a nutshell, we can reject the null hypothesis that banking crises have a differential impact across groups. When the difference is statistically significant, the impact is not persistent over time. This equality of treatments is confirmed for the period 1980-2003 and post 2003. The

psychological costs of banking crises across income groups can be studied only for the episodes prior to 2003. There are no particular reasons to believe that, after conditioning on our rich set of characteristics, SWB losses are more pronounced for the lower income groups. Our analysis shows that first, second and third income quartiles report lower levels of SWB in comparison to the fourth (see the first three columns in Table 8). However, the estimates are statistically significant only for the first and second quartiles. When statistically significant, the difference is also large, with lower income groups experiencing a loss of SWB of 0.118 (on the 4-point scale) in absolute value. Our results also strongly suggest that banking crises do not have a substantially different impact on men and women. The analysis does not find strong evidence that unemployed people are more affected than employed and retired individuals.⁴¹

That the impact of banking crises is not different across groups may come as a surprise but is in line with the idea that a generalised increase in Knightian uncertainty is behind the drop in SWB.

5.7. Heterogeneity across regions

In this section the possibility of heterogeneity arising across European regions is investigated. One meaningful way to look at this is by distinguishing between regions that hosts financial centres (i.e., The Amsterdam region in the Netherlands, London region in UK and so forth) and regions that do not. The hypothesis is that financial centres are more likely to be impacted by the crash than the rest of the country. The coefficient on the triple difference is reported in Table 9 for our four samples. This analysis shows that banking crises hurt more individuals living in regions hosting a financial centre than statistically comparable individuals living in the rest of the country. This effect is statistically significant for every sample considered, including for the latest crisis. For the samples prior the 2007-8 the effect is 0.125 in absolute value for the year immediately after the onset of the crash; this is a 1.5 times bigger compared to a similar specification (Table 4 column 2).

The loss of wellbeing is statistically significant also for individuals in financial centres who experienced the latest crisis. However there is evidence that the drop started before the crisis itself. We will look into this at greater length in the next Section.

[TABLE 9 ABOUT HERE]

⁴¹ Working from home and being a student are not shown. Results are available upon request.

6. Conclusions

This paper contributes to the literature by providing evidence of the impact of banking crises on SWB in Europe for the period 2008-2011.

We do this by combining databases of banking crisis events, compiled by the financial stability literature over the last two decades and updated by Reinhart and Rogoff (2011), with the Eurobarometer surveys. This allows us to identify seventeen banking crises, five of which occurred prior to the latest financial crash. Since the issue of endogeneity can be quite severe, this paper utilizes difference-in-differences techniques to address potential bias.

Overall, our results strongly suggest that financial crises add a non-negligible cost to individual well-being, above and beyond that which can be attributed to losses of personal income, job and GDP and increasing inflation and unemployment rate. There are some evidences that the latest financial crisis hurt more individuals living in regions which host financial centres. For the crises before year 2007, these hidden costs appear to last for at least three years after the crisis and are relatively large. The SWB loss in the first year of the crisis is equivalent to an increase in the unemployment rate of 10 percentage points. A change in income equivalent to moving somebody from the first to the second income quartile is required to hold SWB constant in the first year of the crisis.

For the great recession of 2007-8, we find that the loss in SWB is considerable for those countries which had previously experienced a credit boom. Moreover, using an event study, we find a negative trend in SWB for the majority of the countries starting about three years before the crisis. We are reluctant to call this an anticipatory effect, but we find this an interesting point which deserves further research.

Furthermore, we do not detect any differential impacts across socio-economic groups, suggesting that all individuals appear to be affected by the financial event.

Finally, we argue that the loss in SWB above and beyond that generated by GDP and unemployment could be absorbed when a fiscal channel (e.g., government intervention) and a wealth channel are taken into consideration. When such tests are implemented, the psychological loss is still present.

The results presented in this paper suggest that some fundamental effects of banking crises are not accounted for in the standard literature on the costs of the crises. We suggest that these neglected effects include a deep failure of trust, such as trust in financial institutions or trust in political/regulatory institutions. This is certainly a stimulating topic, which deserves further research. Unfortunately, surveys on trust at European level are either very

sporadic (The World Value Surveys include European countries but there are considerable gaps between successive waves) or began too late (The European Social Surveys start in 2001-2003, while the Eurobarometer includes questions on trust in European Institutions from 1999 only) ⁴². Future research needs to focus on other World regions. This failure could also be a powerful determinant of Knightian uncertainty (i.e., unquantifiable uncertainty, as describes for instance by Caballero and Krishnamurthy, 2008), hence our definition of this failure of trust as a hidden cost having a non-negligible impact on individuals' level of risk, stress and consequently, on the individual's SWB.

⁴² Ehrmann et al. (2013) analyse how trust in the European Central Bank (and other European Institutions) evolved around the great recession of 2007-8 and show that there is a decline across European countries. However, from our point of view, trust in European Institutions is a limited concept.

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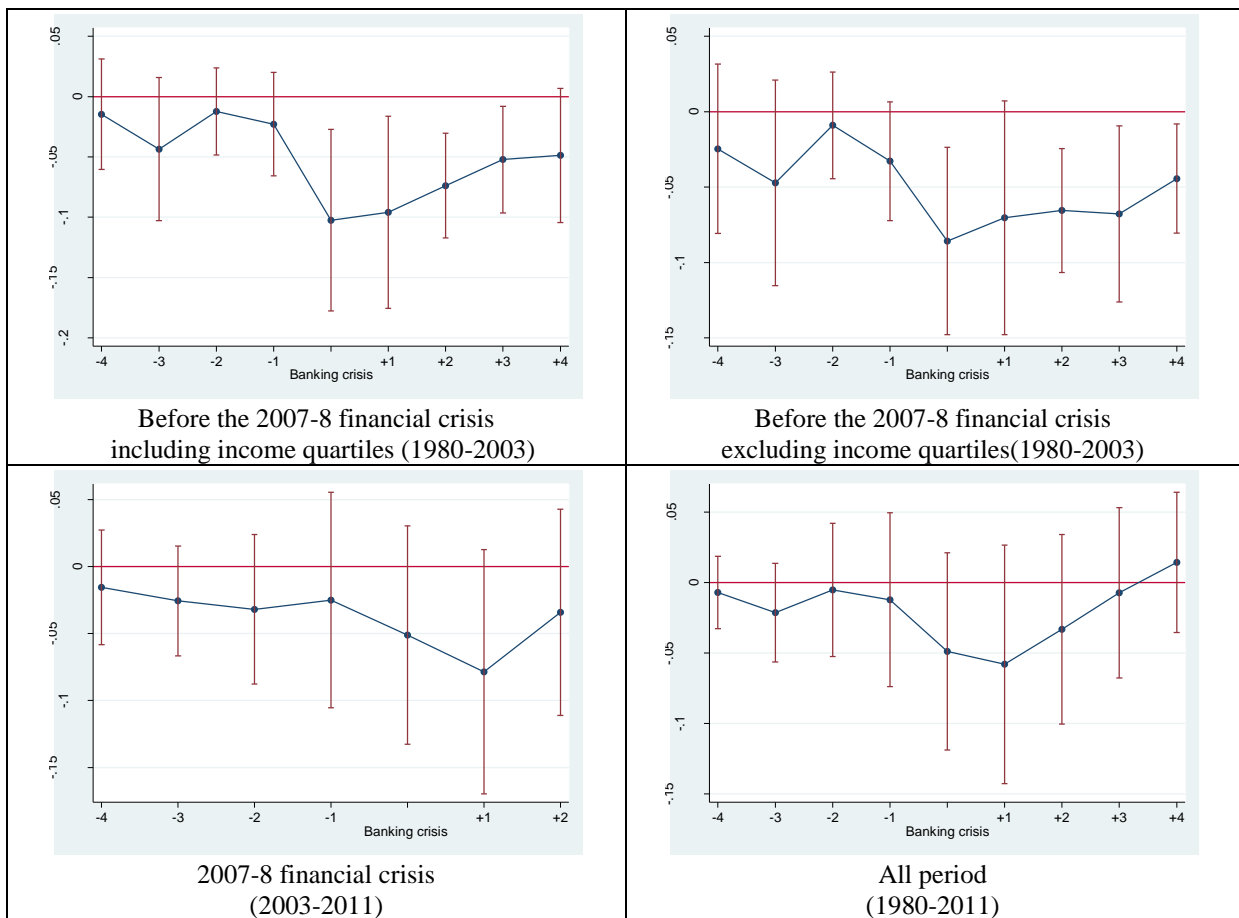
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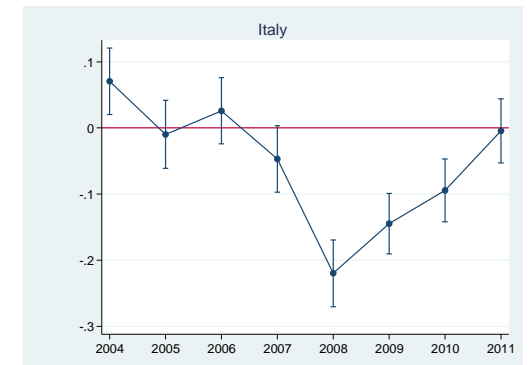
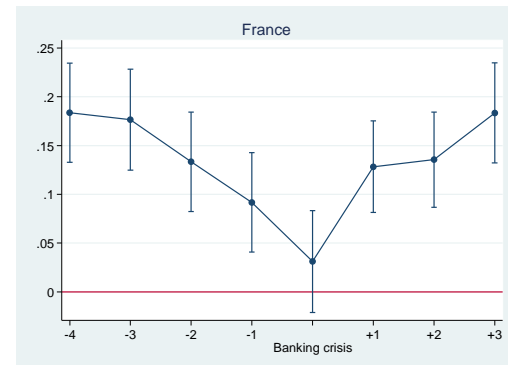
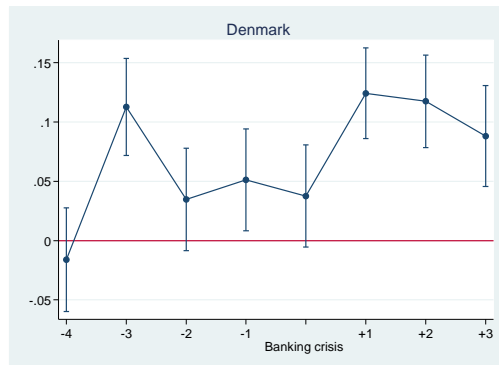
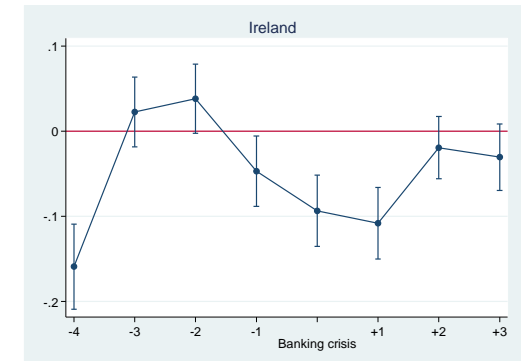
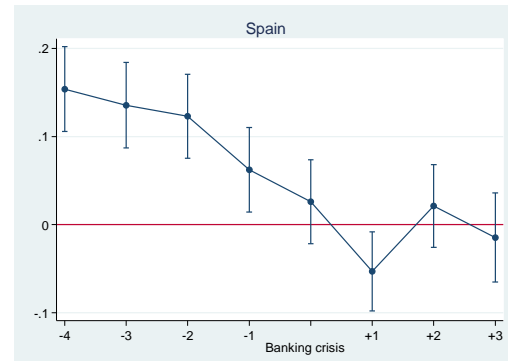
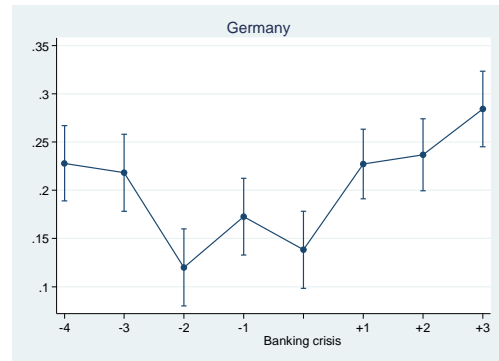
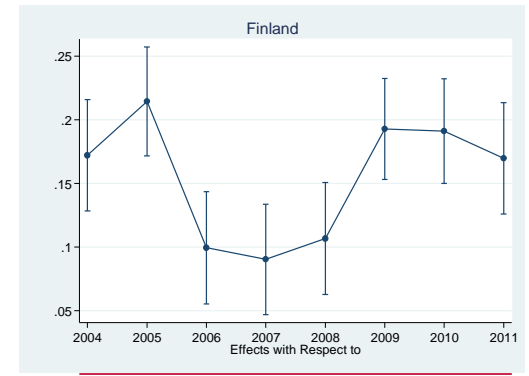
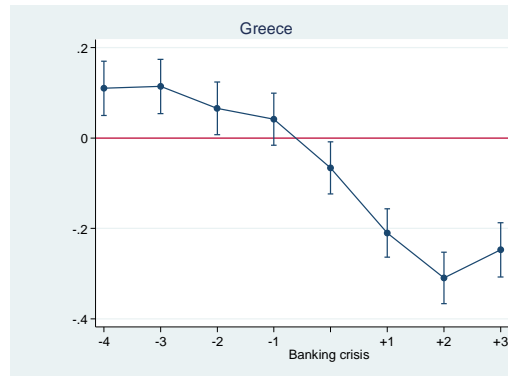
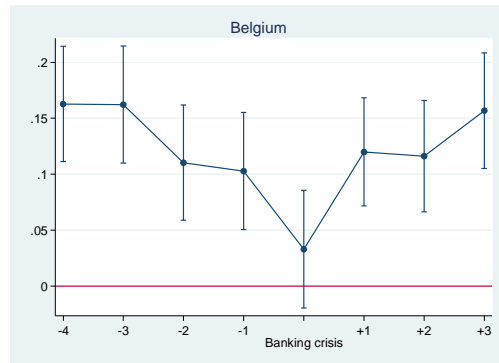
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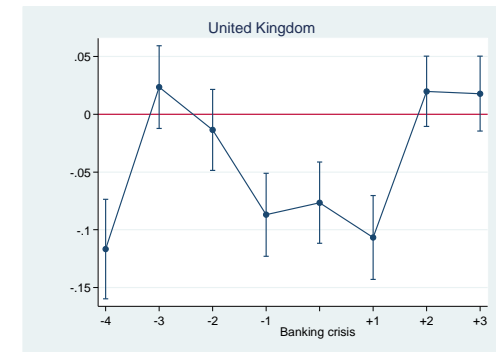
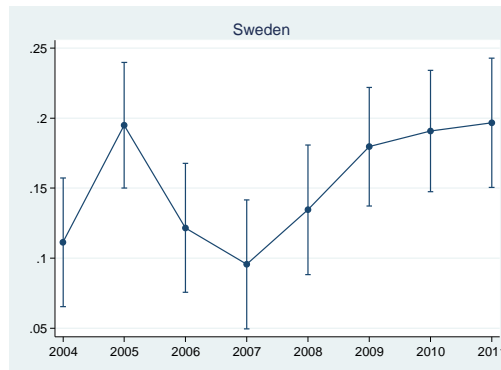
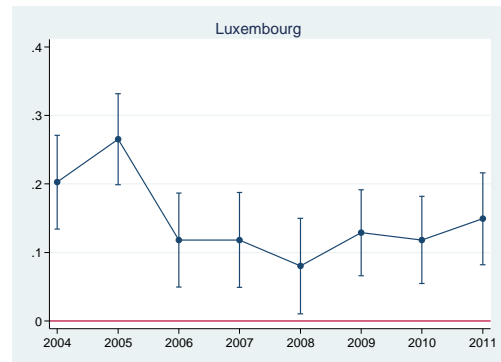
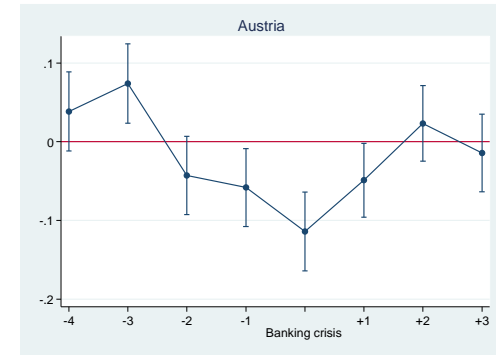
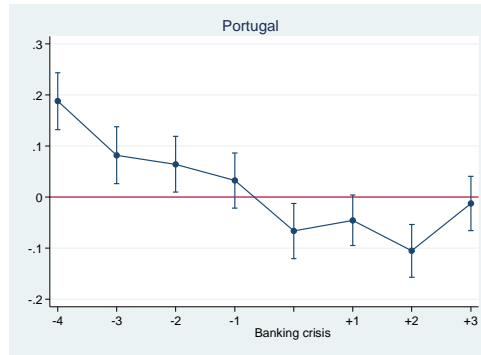
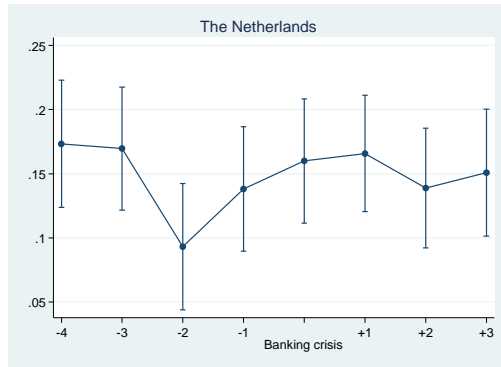
Figure 1. Pre-treatments and persistence



Note: Each plot summarises regression results from Table 4. Each dots represent the estimated effect of banking crisis on SWB with respect to the beginning of the banking crisis. 90% of confidence level are reported. The beginning of the banking crises is normalised at year 0. On the horizontal axis, the labels: -1, -2,...(+1, +2, ...) represent the number of years leading to (following) the starting date of the banking crisis. They correspond to parameters ξ_{-4} through ξ_{+4} in equation (4). There are four plots corresponding to the four columns (samples) of Table 4.

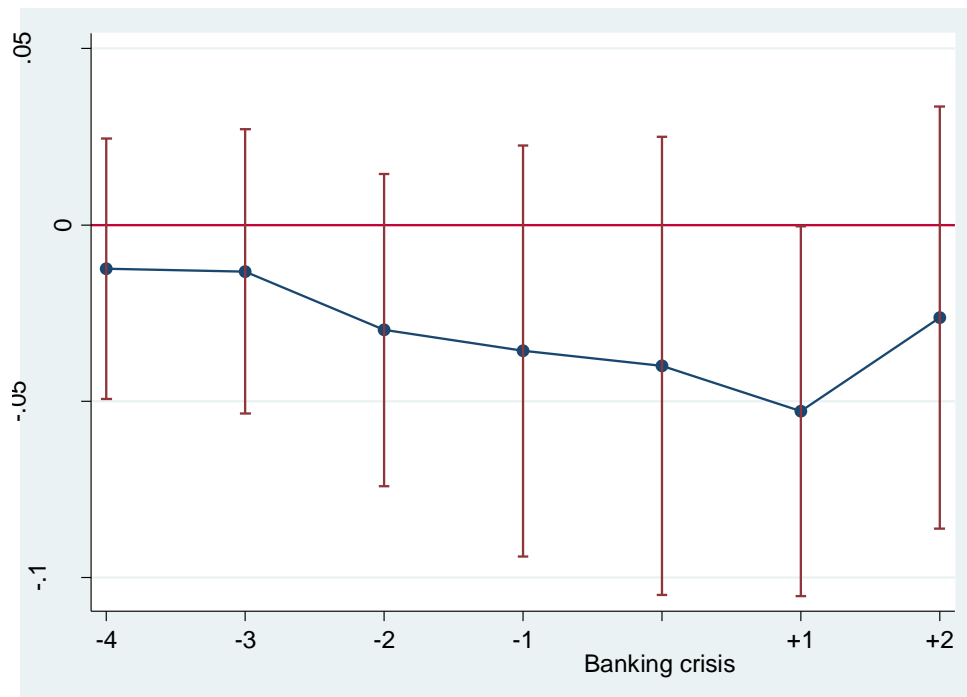
Figure 2. 2007-8 financial crisis – event studies at country level





Note: Each plot summarises separate regression results by country. Each dots represent the estimated effect of the latest 2007-2008 banking crisis on SWB with respect to the beginning of the banking crisis, which vary between 2007 and 2008 depending on the country. 90% of confidence level are reported. The beginning of the banking crises is normalised at year 0. On the horizontal axis, the labels -1, -2,...(+1, +2, ...) represent the number of years leading to (following) the starting date of the banking crisis. They correspond to parameters ξ_{-4} through ξ_{+4} in equation (4).

Figure 3. The effect of the 2007-8 financial crisis on SWB when the control group includes Eastern European countries



Note: . Each dots represent the estimated effect of banking crisis on SWB with respect to the beginning of the banking crisis. 90% of confidence level based on two-way clustered standard errors at country and year level are reported. The beginning of the banking crises is normalised at year 0. On the horizontal axis, the labels: -1, -2,...(+1, +2, ...) represent the number of years leading to (following) the starting date of the banking crisis. They correspond to parameters ξ_{-4} through ξ_{+2} in equation (4).

Table 1. Treatment group of countries and year ξ_0 of the banking crisis

| Before the 2007-8 financial crisis (1980-2003) | 2007-8 financial crisis (2003-2011) |
|---|--|
| Denmark, 1987 | Denmark, 2008 |
| Greece, 1991 | Greece, 2008 |
| France, 1994 | France, 2008 |
| UK, 1991 | UK, 2007 |
| Italy, 1990 | |
| | Ireland, 2007 |
| | Germany, 2008 |
| | The Netherlands, 2008 |
| | Austria, 2007 |
| | Portugal, 2007 |
| | Belgium, 2008 |
| | Spain, 2008 |

Notes: The table portrays episodes for which we have life satisfaction data for the first year of the crisis. There are five episodes for which we have life satisfaction data around the starting of the banking crisis, but not for year ξ_0 (see equation (4)) because Eurobarometer surveys were discontinuous in those countries. They are Norway 1987, Finland 1991, Sweden 1991, Iceland, 2007 and Switzerland, 2007. In particular, for Finland and Sweden, surveys are available only for year ξ_{+4} , while for Norway only for ξ_{+3} and ξ_{+4} . For Iceland, Eurobarometer surveys are available only for year ξ_{+3} and ξ_{+4} , and year ξ_{-2} , while for Switzerland, the only Eurobarometer survey is conducted 3 years before its crisis (ξ_{-3}).

Table 2. Descriptive statistics

| | Before the 2007-8 financial crisis (1980-2003) | | 2007-8 Financial crisis (2003-2011) | |
|------------------------------|---|--------|--|--------|
| | Mean | St Dev | Mean | St Dev |
| Life satisfaction | 3.05 | 0.77 | 3.13 | 0.76 |
| Occupational status: | | | | |
| Unemployed | 0.07 | 0.25 | 0.06 | 0.24 |
| Self-employed | 0.08 | 0.27 | 0.08 | 0.27 |
| Retired | 0.20 | 0.40 | 0.27 | 0.44 |
| House keeping | 0.15 | 0.36 | 0.09 | 0.29 |
| Student | 0.06 | 0.24 | 0.08 | 0.26 |
| Military | 0.01 | 0.02 | - | - |
| Income: | | | | |
| First income quartile | 0.25 | 0.43 | - | - |
| Second income quartile | 0.25 | 0.43 | - | - |
| Third income quartile | 0.25 | 0.43 | - | - |
| Fourth income quartile | 0.25 | 0.43 | - | - |
| Marital status: | | | | |
| Married | 0.63 | 0.48 | 0.62 | 0.49 |
| Single | 0.23 | 0.42 | 0.21 | 0.41 |
| Divorced/separated | 0.06 | 0.23 | 0.08 | 0.27 |
| Widowed | 0.08 | 0.28 | 0.09 | 0.28 |
| Female | 0.51 | 0.50 | 0.53 | 0.50 |
| Age | 44.11 | 17.80 | 48.42 | 18.14 |
| Education: | | | | |
| No full-time education | 0.01 | 0.14 | 0.01 | 0.08 |
| Still in full-time education | 0.08 | 0.27 | 0.08 | 0.27 |
| Up to 14 years | 0.26 | 0.44 | 0.16 | 0.37 |
| 15 years | 0.08 | 0.27 | 0.08 | 0.27 |
| 16 years | 0.12 | 0.32 | 0.10 | 0.30 |
| 17 years | 0.07 | 0.26 | 0.07 | 0.25 |
| 18 years | 0.11 | 0.31 | 0.13 | 0.33 |
| 19 years | 0.05 | 0.23 | 0.07 | 0.25 |
| 20 years | 0.04 | 0.21 | 0.05 | 0.22 |
| 21 years | 0.03 | 0.18 | 0.04 | 0.21 |
| 22 years or older | 0.14 | 0.35 | 0.22 | 0.41 |
| Macroeconomic controls | | | | |
| Inflation | 0.05 | 0.05 | 0.02 | 0.01 |
| Unemployment rate | 0.09 | 0.04 | 0.08 | 0.03 |
| Log of GDP | 10.09 | 0.25 | 10.37 | 0.20 |

Table 3. Basic OLS happiness regressions

| | Before the 2007-8 financial crisis | | 2007-8 Financial crisis | All period |
|----------------------------|------------------------------------|---------------------|-------------------------|-------------------|
| | (1980-2003) | | (2003-2011) | (1980-2011) |
| | (1) | (2) | (3) | (4) |
| Banking crisis (ξ_0) | -0.073** (0.032) | -0.056** (0.027) | -0.007 (0.030) | -0.033 (0.028) |
| Quartiles of income | Yes | No | No | No |
| Country fixed effects | Yes | Yes | Yes | Yes |
| Year fixed effects | Yes | Yes | Yes | Yes |
| Macroeconomic controls | Yes | Yes | Yes | Yes |
| Individual characteristics | Yes | Yes | Yes | Yes |
| Observations | 459,799 | 633,687 | 315,877 | 933,943 |
| R-squared | 0.188 | 0.164 | 0.237 | 0.186 |

Notes: Macroeconomic controls are the standard controls used in the literature: log of GDP, inflation and unemployment rate at country level. Individual characteristics include gender, age and age-squared, indicators of marital status, education and a complete set of employment status dummy variables. Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$.

Table 4. The causal effect of banking crises on SWB; lagged and anticipatory effects

| Event years ξ_n | Before the 2007-8 financial crisis (1980-2003) | | 2007-8 Financial crisis (2003-2011) | All period (1980-2011) |
|----------------------------|--|----------------------|-------------------------------------|------------------------|
| | (1) | (2) | (3) | (4) |
| -4 years | -0.015 (0.028) | -0.025 (0.034) | -0.016 (0.026) | -0.007 (0.016) |
| -3 years | -0.043 (0.036) | -0.047 (0.041) | -0.026 (0.025) | -0.021 (0.021) |
| -2 years | -0.012 (0.022) | -0.009 (0.022) | -0.032 (0.034) | -0.005 (0.029) |
| -1 year | -0.023 (0.026) | -0.033 (0.024) | -0.025 (0.049) | -0.012 (0.038) |
| Banking crisis (ξ_0) | -0.102** (0.046) | -0.086** (0.038) | -0.051 (0.050) | -0.049 (0.043) |
| +1 year | -0.096** (0.048) | -0.070 (0.047) | -0.079 (0.055) | -0.058 (0.051) |
| +2 years | -0.074*** (0.026) | -0.066*** (0.025) | -0.034 (0.047) | -0.033 (0.041) |
| +3 years | -0.052** (0.027) | -0.068* (0.035) | | -0.007 (0.037) |
| +4 years | -0.049 (0.034) | -0.044** (0.022) | | 0.014 (0.030) |
| Quartiles of income | Yes | No | No | No |
| Country fixed effects | Yes | Yes | Yes | Yes |
| Year fixed effects | Yes | Yes | Yes | Yes |
| Macroeconomic controls | Yes | Yes | Yes | Yes |
| Individual characteristics | Yes | Yes | Yes | Yes |
| Observations | 459,799 | 633,687 | 315,877 | 933,943 |
| R-squared | 0.188 | 0.164 | 0.237 | 0.186 |

Notes: Macroeconomic controls are the standard controls used in the literature: log of GDP, inflation and unemployment rate at country level. Individual characteristics include gender, age and age-squared, indicators of marital status, education and a complete set of employment status dummy variables. Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$.

Table 5. The causal effect of the 2007-8 financial crisis on SWB following the credit boom and house prices

| Interaction with event years ξ_n | | Interaction with event years ξ_n | |
|---------------------------------------|-------------------|--------------------------------------|--------------------|
| (house price growth) (-4 years) | -0.005 (0.006) | (credit boom) (-4 years) | 0.011 (0.056) |
| (house price growth) (-3 years) | -0.003 (0.004) | (credit boom) (-3 years) | -0.012 (0.042) |
| (house price growth) (-2 years) | 0.000 (0.005) | (credit boom) (-2 years) | 0.003 (0.047) |
| (house price growth) (-1 year) | -0.007 (0.007) | (credit boom) (-1 year) | -0.045 (0.051) |
| (house price growth) (Banking crisis) | -0.007 (0.005) | (credit boom) (Banking crisis) | -0.034 (0.037) |
| (house price growth) (+1 year) | -0.006 (0.007) | (credit boom) (+1 year) | -0.110* (0.065) |
| (house price growth) (+2 years) | 0.001 (0.005) | (credit boom) (+2 years) | -0.056 (0.063) |
| Country fixed effects | Yes | Country fixed effects | Yes |
| Year fixed effects | Yes | Year fixed effects | Yes |
| Macroeconomic controls | Yes | Macroeconomic controls | Yes |
| Individual characteristics | Yes | Individual characteristics | Yes |
| Observations | 292,486 | Observations | 315,877 |
| R-squared | 0.237 | R-squared | 0.237 |

Notes: This table shows the estimated coefficients on the interaction terms between the credit boom indicator and the banking crisis leads and lags only. Macroeconomic controls are the standard controls used in the literature: log of GDP, inflation and unemployment rate at country level. Individual characteristics include gender, age and age-squared, indicators of marital status, education and a complete set of employment status dummy variables. Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$.

Table 6. Channels

| Event years ξ_n | Before the 2007-8 financial crisis | | | | 2007-8 financial crisis | | | |
|-----------------------------|------------------------------------|----------------------|----------------------|----------------------|-------------------------|-------------------|--------------------|--------------------|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| -4 years | -0.007 (0.026) | -0.008 (0.026) | 0.023 (0.027) | 0.018 (0.032) | -0.008 (0.021) | -0.022 (0.028) | -0.025 (0.021) | -0.027* (0.016) |
| -3 years | -0.030 (0.042) | -0.030 (0.046) | -0.002 (0.041) | -0.002 (0.050) | -0.018 (0.022) | -0.034 (0.030) | -0.033* (0.018) | -0.036 (0.023) |
| -2 years | -0.002 (0.033) | -0.002 (0.034) | -0.046** (0.019) | -0.050** (0.022) | -0.026 (0.029) | -0.040 (0.038) | -0.041 (0.033) | -0.047 (0.031) |
| -1 year | -0.008 (0.035) | -0.008 (0.030) | 0.012 (0.042) | 0.004 (0.051) | -0.023 (0.047) | -0.028 (0.048) | -0.029 (0.043) | -0.033 (0.040) |
| Banking crisis (ξ_0) | -0.090*** (0.034) | -0.089*** (0.028) | -0.059** (0.024) | -0.069** (0.027) | -0.049 (0.049) | -0.055 (0.049) | -0.049 (0.045) | -0.052 (0.045) |
| +1 year | -0.081** (0.037) | -0.081** (0.035) | -0.089** (0.036) | -0.089** (0.036) | -0.082 (0.060) | -0.083 (0.057) | -0.063 (0.047) | -0.071 (0.047) |
| +2 years | -0.074*** (0.022) | -0.074*** (0.020) | -0.062*** (0.022) | -0.069*** (0.018) | -0.037 (0.052) | -0.037 (0.048) | -0.043 (0.047) | -0.050 (0.045) |
| +3 years | -0.059** (0.023) | -0.059** (0.024) | -0.053* (0.027) | -0.055** (0.022) | | | | |
| +4 years | -0.063* (0.038) | -0.064* (0.036) | -0.047* (0.027) | -0.055* (0.029) | | | | |
| Government consumption | Yes | No | No | Yes | Yes | Yes | No | Yes |
| Tax burden | No | Yes | No | Yes | No | No | Yes | Yes |
| Annual stock market returns | No | No | Yes | Yes | No | No | No | Yes |
| Quartiles of income | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Country fixed effects | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Year fixed effects | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Macroeconomic controls | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Individual characteristics | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Observations | 314,160 | 422,455 | 393,600 | 377,532 | 315,877 | 315,877 | 314,160 | 314,160 |
| R-squared | 0.236 | 0.196 | 0.194 | 0.199 | 0.237 | 0.237 | 0.236 | 0.236 |

Notes: Macroeconomic controls are the standard controls used in the literature: log of GDP, inflation and unemployment rate at country level. Individual characteristics include gender, age and age-squared, indicators of marital status, education and a complete set of employment status dummy variables. Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$.

Table 7. The causal effect of negative growth on SWB

| | Before the 2007-8 Financial crisis (1980-2003) | | | |
|-----------------------------|---|--------------------|--------------------|---------------------|
| Event years ξ_n | (1) | (2) | (3) | (4) |
| -4 years | 0.030 (0.023) | 0.026 (0.025) | 0.025 (0.022) | 0.016 (0.023) |
| -3 years | 0.008 (0.028) | 0.002 (0.028) | 0.002 (0.027) | -0.011 (0.029) |
| -2 years | 0.017 (0.023) | 0.011 (0.025) | 0.011 (0.025) | 0.018 (0.026) |
| -1 year | -0.005 (0.021) | -0.013 (0.023) | -0.013 (0.023) | -0.017 (0.024) |
| Negative growth (ξ_0) | -0.037 (0.023) | -0.046 (0.031) | -0.046 (0.030) | -0.020 (0.022) |
| +1 year | -0.055 (0.034) | -0.073* (0.042) | -0.074* (0.041) | -0.076** (0.031) |
| +2 years | 0.003 (0.032) | 0.008 (0.036) | 0.008 (0.036) | -0.026 (0.035) |
| +3 years | 0.047** (0.021) | 0.045* (0.025) | 0.045* (0.025) | 0.037 (0.026) |
| +4 years | 0.026 (0.022) | 0.023 (0.024) | 0.022 (0.024) | 0.019 (0.029) |
| Annual stock returns | No | No | No | Yes |
| Tax burden | No | No | Yes | Yes |
| Government consumption | No | Yes | Yes | Yes |
| Quartiles of income | Yes | Yes | Yes | Yes |
| Country fixed effects | Yes | Yes | Yes | Yes |
| Year fixed effects | Yes | Yes | Yes | Yes |
| Macroeconomic controls | Yes | Yes | Yes | Yes |
| Individual characteristics | Yes | Yes | Yes | Yes |
| Observations | 459,799 | 422,455 | 422,455 | 377,532 |
| R-squared | 0.189 | 0.197 | 0.197 | 0.200 |

Notes: Negative growth is when a country experienced a year of negative GDP growth. Macroeconomic controls are the standard controls used in the literature: log of GDP, inflation and unemployment rate at country level. Individual characteristics include gender, age and age-squared, indicators of marital status, education and a complete set of employment status dummy variables. Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$.

Table 8. Heterogeneity of the effect of banking crises on SWB prior to 2007-8 financial crisis

| Event years ξ_n | Income quartiles (Ref. cat. Fourth) | | | Gender | Employment status (Ref. cat: employed) | | | Employment status (Ref. cat: employed) | | |
|----------------------------|-------------------------------------|---------------------|--------------------|-------------------|--|--------------------|--------------------|--|--------------------|--------------------|
| | First | Second | Third | Female | Unemployed | Self-employed | Retired | Female | Unemploy ed | Self-employed |
| -4 years | -0.014 (0.057) | 0.026 (0.020) | 0.019* (0.010) | -0.003 (0.017) | -0.008 (0.067) | -0.037 (0.041) | 0.069 (0.047) | -0.020 (0.022) | 0.033 (0.065) | -0.026 (0.025) |
| -3 years | 0.012 (0.050) | 0.043 (0.032) | 0.013 (0.025) | 0.014 (0.029) | 0.035 (0.104) | 0.035 (0.047) | 0.090** (0.039) | -0.014 (0.020) | -0.050 (0.070) | -0.041* (0.024) |
| -2 years | -0.055* (0.028) | -0.011 (0.012) | -0.037* (0.018) | -0.012 (0.018) | 0.032 (0.052) | 0.096** (0.046) | 0.030 (0.043) | -0.009 (0.020) | -0.021 (0.065) | 0.010 (0.029) |
| -1 year | -0.003 (0.021) | -0.024 (0.024) | 0.001 (0.019) | -0.004 (0.032) | 0.054 (0.060) | -0.008 (0.032) | 0.029 (0.032) | -0.019 (0.019) | 0.007 (0.066) | -0.014 (0.031) |
| Banking crisis (ξ_0) | -0.006 (0.053) | -0.118** (0.052) | -0.035 (0.034) | -0.005 (0.042) | 0.138** (0.067) | -0.082 (0.055) | 0.025 (0.052) | -0.038** (0.019) | 0.005 (0.064) | 0.004 (0.024) |
| +1 year | -0.118** (0.046) | 0.012 (0.027) | -0.039 (0.026) | -0.013 (0.027) | 0.046 (0.076) | -0.039 (0.035) | -0.014 (0.054) | -0.008 (0.018) | -0.109* (0.062) | -0.052 (0.058) |
| + 2 years | -0.011 (0.042) | -0.013 (0.010) | 0.017 (0.011) | -0.008 (0.029) | 0.040 (0.062) | -0.033 (0.046) | 0.056 (0.036) | -0.022 (0.027) | -0.089 (0.082) | -0.028 (0.052) |
| +3 years | -0.034 (0.055) | 0.033 (0.023) | -0.027 (0.028) | -0.008 (0.025) | 0.030 (0.075) | -0.056* (0.031) | 0.015 (0.034) | | | |
| +4 years | 0.001 (0.071) | 0.026 (0.020) | 0.021 (0.018) | -0.049 (0.045) | 0.088 (0.083) | -0.004 (0.025) | 0.023 (0.032) | | | |
| Quartiles of income | Yes | Yes | Yes | Yes | Yes | Yes | Yes | No | No | No |
| Observations | | 422,455 | | 422,455 | | 422,455 | | 315,877 | | 315,877 |
| R-squared | | 0.196 | | 0.196 | | 0.197 | | 0.237 | | 0.238 |

Notes: The table shows estimates from four separate regressions in which banking crisis lags and leads are interacted with marital status, gender, income quartiles and employment status indicators, respectively. Every panel shows the triple interaction term from these separate regressions. The last columns show only selected employment status indicators. Macroeconomic controls include log of GDP, inflation, unemployment rate and government consumption. Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$.

Table 9. The effect of banking crises on SWB in regions with financial centres

| Event years ξ_n | Before the 2007-8 financial crisis (1980-2003) | | 2007-8 financial crisis (2003-2011) | All period (1980-2011) |
|------------------------------------|---|----------------------|--|---------------------------|
| | (1) | (2) | (3) | (4) |
| (financial centre) (-4 years) | 0.019 (0.072) | 0.017 (0.078) | -0.036 (0.029) | -0.024 (0.038) |
| (financial centre)(-3 years) | -0.055 (0.073) | -0.028 (0.065) | -0.062** (0.025) | -0.064** (0.029) |
| (financial centre)(-2 years) | -0.055 (0.034) | -0.037 (0.034) | -0.041* (0.024) | -0.046*** (0.017) |
| (financial centre)(-1 year) | 0.015 (0.042) | 0.035 (0.045) | -0.035* (0.019) | -0.018 (0.028) |
| (financial centre)(Banking crisis) | -0.036 (0.044) | 0.005 (0.047) | -0.061*** (0.024) | -0.050** (0.025) |
| (financial centre)(+1 year) | -0.112*** (0.035) | -0.111*** (0.039) | -0.063** (0.031) | -0.087*** (0.028) |
| (financial centre)(+2 years) | -0.062 (0.052) | -0.035 (0.053) | -0.087*** (0.025) | -0.082** (0.034) |
| (financial centre)(+3 years) | -0.067 (0.052) | -0.088 (0.059) | | -0.101*** (0.032) |
| (financial centre)(+4 years) | -0.041 (0.049) | 0.006 (0.072) | | -0.015 (0.041) |
| Quartiles of income | Yes | No | No | No |
| Country fixed effects | Yes | Yes | Yes | Yes |
| Year fixed effects | Yes | Yes | Yes | Yes |
| Macroeconomic controls | Yes | Yes | Yes | Yes |
| Individual characteristics | Yes | Yes | Yes | Yes |
| Observations | | | | |
| R-squared | | | | |

Notes: This table shows the estimated coefficients on the interaction terms between the financial centre indicator and the banking crisis leads and lags only. Macroeconomic controls include log of GDP, inflation, unemployment rate and government consumption. Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$.

Online Appendix

Table A1: A Summary of near systemic banking crises by events across our sample of 18 European countries, 1980-2011

| Country | Brief Summary | Year ξ_0 | Sources |
|------------------------|---|-----------------|--|
| Belgium | 2007-8 Financial crisis | 2008 | Reinhart and Rogoff (2011) |
| Denmark | Two small banks collapsed and shook the banking system leading to moves to curb bank lending. Cumulative losses over 1990–92 were 9% of loans; 40 of 60 problem banks were merged. | 1987 | Kaminsky and Reinhart (1999); Caprio and Klingebiel (2003); Bordo et al. (2001); Reinhart and Rogoff (2011) |
| | 2007-8 Financial crisis | 2008 | Reinhart and Rogoff (2011) |
| Germany | 2007-8 Financial crisis | 2008 | Reinhart and Rogoff (2011) |
| Greece | Localized problems required significant injections of public funds | 1991 | Bordo et al. (2001), Reinhart (2002), Caprio and Klingebiel (2003); Reinhart and Rogoff (2011) |
| | 2007-8 Financial crisis | 2008 | Reinhart and Rogoff (2011) |
| Spain | 2007-8 Financial crisis | 2008 | Reinhart and Rogoff (2011) |
| Finland | A large bank (Skopbank) collapsed on September 19 and was intervened. Savings banks were badly affected; the government took control of three banks that together accounted for 31 percent of system deposits. | 1991 | Kaminsky and Reinhart (1999); Jonung and Hagberg (2002); Caprio and Klingebiel (2003); Bordo et al. (2001); Reinhart and Rogoff (2011) |
| France | Crédit Lyonnaise had serious solvency problems | 1994 | Caprio and Klingebiel (2003); Bordo et al. (2001) |
| | 2007-8 Financial crisis | 2008 | Reinhart and Rogoff (2011) |
| Ireland | 2007-8 Financial crisis | 2007 | Reinhart and Rogoff (2011); |
| Italy | Fifty-eight banks, with 11 percent of lending, merged with other institutions | 1990 | Caprio and Klingebiel (2003); Bordo et al. (2001); Reinhart and Rogoff (2011) |
| The Netherlands | 2007-8 Financial crisis | 2008 | Reinhart and Rogoff (2011) |
| Austria | 2007-8 Financial crisis | 2007 | Reinhart and Rogoff (2011) |
| Portugal | 2007-8 Financial crisis | 2007 | Reinhart and Rogoff (2011) |
| Sweden | The Swedish government rescued Nordbanken, the second largest bank. Nordbanken and Gota Bank, accounting for 22 percent of banking system assets, were insolvent. Sparbanken Foresta, accounting for 24 percent of banking system assets, intervened. Overall, five of the six largest banks, accounting for more than 70 percent of banking system assets, experienced | 1991 | Kaminsky and Reinhart (1999); Jonung and Hagberg (2002); Caprio and Klingebiel (2003); Bordo et al. (2001); Reinhart and Rogoff (2011) |

difficulties.

| | | | |
|--------------------|--|------|--|
| UK | The Bank of Credit and Commerce International failed | 1991 | Caprio and Klingebiel (2003); Reinhart and Rogoff (2011) |
| | 2007-8 Financial crisis | 2007 | |
| Iceland | 2007-8 Financial crisis | 2007 | Reinhart and Rogoff (2011) |
| Switzerland | 2007-8 Financial crisis | 2007 | Reinhart and Rogoff (2011) |
| Norway | Two regional saving banks failed. The banks were eventually merged and bailed out. The Central Bank provided special loans to six banks suffering from the recession of 1985–86 and from problem real estate loans. The state took control of the three largest banks with 85% of banking system assets. | 1987 | Reinhart and Rogoff (2011) |

Note: Eurobarometer surveys are not administered every year in Finland, Sweden, Norway, Iceland and Switzerland. As a result, life satisfaction data cannot be merged with the date of the beginning of the crisis for those episodes. Instead of dropping those observations, when running the dynamic DD model, we use information on life satisfaction data as leads or lags if surveys were conducted in years leading to or following the financial crisis. In particular, for Finland and Sweden, surveys are available only for year ξ_{+4} , while for Norway only for ξ_{+3} and ξ_{+4} . For Iceland, Eurobarometer surveys are available only for year ξ_{+3} and ξ_{+4} , and year ξ_{-2} , while for Switzerland, the only Eurobarometer survey is conducted 3 years before its crisis (ξ_{-3}).

Table A2. The causal effect of financial crisis on SWB – All banking crisis

| | Before 2003 | Before 2003 | 1980-2011 |
|----------------------------|----------------------|--------------------|-------------------|
| Event years ξ_n | (1) | (2) | (3) |
| -4 years | -0.018 (0.018) | -0.010 (0.015) | -0.015 (0.014) |
| -3 years | -0.045 (0.029) | -0.048 (0.028) | -0.028 (0.017) |
| -2 years | -0.003 (0.015) | -0.005 (0.015) | -0.001 (0.021) |
| -1 year | -0.022 (0.015) | -0.016 (0.015) | -0.009 (0.027) |
| Banking crisis (ξ_0) | -0.063* (0.034) | -0.075* (0.042) | -0.040 (0.036) |
| +1 year | -0.056 (0.048) | -0.065 (0.056) | -0.053 (0.049) |
| +2 years | -0.051 (0.030) | -0.059* (0.028) | -0.030 (0.036) |
| +3 years | -0.044 (0.041) | -0.037 (0.030) | -0.011 (0.029) |
| +4 years | -0.040*** (0.011) | -0.033* (0.018) | -0.013 (0.019) |
| Quartiles of income | No | Yes | No |
| Country fixed effects | Yes | Yes | Yes |
| Year fixed effects | Yes | Yes | Yes |
| Macroeconomic controls | Yes | Yes | Yes |
| Individual characteristics | Yes | Yes | Yes |
| Observations | 459,799 | 422,455 | 422,455 |
| R-squared | 0.189 | 0.197 | 0.197 |

Notes: Standard errors cluster at country level. In parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$. Macroeconomic controls are the standard controls used in the literature: log of GDP, inflation and unemployment rate at country level. Individual characteristics include gender, age and age-squared, indicators of marital status, education and a complete set of employment status dummy variables.

Table A3. The causal effect of financial crisis on SWB controlling for financial structure

| Interaction with event years ξ_n | (1) | (2) | (3) | (4) |
|--|-------------------|-------------------|-------------------|-------------------|
| (financial structure) (-4 years) | 0.001 (0.017) | 0.003 (0.017) | -0.004 (0.016) | -0.005 (0.013) |
| (financial structure) (-3 years) | -0.003 (0.011) | -0.001 (0.012) | -0.007 (0.011) | -0.011 (0.010) |
| (financial structure) (-2 years) | -0.006 (0.016) | -0.006 (0.015) | -0.008 (0.015) | -0.017 (0.018) |
| (financial structure) (-1 year) | -0.005 (0.016) | -0.005 (0.016) | -0.005 (0.016) | -0.006 (0.015) |
| (financial structure) (Banking crisis) | 0.001 (0.012) | 0.001 (0.012) | 0.002 (0.013) | 0.002 (0.012) |
| (financial structure) (+1 year) | 0.017 (0.015) | 0.015 (0.017) | 0.016 (0.017) | 0.016 (0.014) |
| (financial structure) (+2 years) | 0.011 (0.013) | 0.010 (0.015) | 0.010 (0.014) | 0.008 (0.015) |
| Annual stock returns | No | No | No | Yes |
| Tax burden | No | No | Yes | Yes |
| Government consumption | No | Yes | Yes | Yes |
| Quartiles of income | No | No | No | No |
| Country fixed effects | Yes | Yes | Yes | Yes |
| Year fixed effects | Yes | Yes | Yes | Yes |
| Macroeconomic controls | Yes | Yes | Yes | Yes |
| Individual characteristics | Yes | Yes | Yes | Yes |
| Observations | 295,802 | 295,802 | 295,802 | 294,085 |
| R-squared | 0.245 | 0.245 | 0.245 | 0.244 |

Notes: Standard errors adjusted for two-way clustering at country and year level as proposed by Cameron et al. (2011) in parentheses, *** $p \leq 0.01$, ** $p \leq 0.05$, * $p \leq 0.1$. Macroeconomic controls are the standard controls used in the literature: log of GDP, inflation and unemployment rate at country level. Individual characteristics include gender, age and age-squared, indicators of marital status, education and a complete set of employment status dummy variables.

Table A4: Evolution of SWB during the 2007-8 crisis

| Panel A: Average annual SWB by country | | | | | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Belgium | 3.04 | 3.25 | 3.25 | 3.19 | 3.18 | 3.12 | 3.21 | 3.20 | 3.25 |
| Denmark | 3.57 | 3.57 | 3.69 | 3.61 | 3.63 | 3.61 | 3.70 | 3.69 | 3.64 |
| Germany | 2.76 | 3.02 | 3.03 | 2.90 | 2.97 | 2.94 | 3.03 | 3.05 | 3.09 |
| Greece | 2.67 | 2.78 | 2.77 | 2.71 | 2.68 | 2.57 | 2.43 | 2.34 | 2.38 |
| Spain | 3.02 | 3.14 | 3.13 | 3.10 | 3.06 | 2.99 | 2.90 | 2.97 | 2.93 |
| Finland | 3.15 | 3.33 | 3.38 | 3.25 | 3.26 | 3.27 | 3.36 | 3.35 | 3.31 |
| France | 2.85 | 3.05 | 3.04 | 2.99 | 2.96 | 2.90 | 2.98 | 3.00 | 3.02 |
| Ireland | 3.16 | 3.36 | 3.38 | 3.28 | 3.23 | 3.22 | 3.29 | 3.28 | 3.29 |
| Italy | 2.86 | 2.92 | 2.85 | 2.87 | 2.79 | 2.62 | 2.70 | 2.76 | 2.85 |
| Luxembourg | 3.25 | 3.47 | 3.54 | 3.38 | 3.39 | 3.34 | 3.39 | 3.40 | 3.42 |
| The Netherlands | 3.29 | 3.46 | 3.48 | 3.39 | 3.44 | 3.47 | 3.48 | 3.47 | 3.47 |
| Austria | 3.08 | 3.14 | 3.16 | 3.05 | 3.05 | 2.98 | 3.04 | 3.12 | 3.07 |
| Portugal | 2.50 | 2.64 | 2.53 | 2.50 | 2.52 | 2.41 | 2.42 | 2.34 | 2.44 |
| Sweden | 3.29 | 3.42 | 3.51 | 3.43 | 3.41 | 3.45 | 3.49 | 3.49 | 3.47 |
| UK | 3.19 | 3.32 | 3.29 | 3.21 | 3.22 | 3.19 | 3.32 | 3.33 | 3.30 |
| Panel B: Average annual change in SWB by country | | | | | | | | | |
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Belgium | | 7% | 0% | -2% | 0% | -2% | 3% | 0% | 2% |
| Denmark | | 0% | 3% | -2% | 0% | 0% | 2% | 0% | -1% |
| Germany | | 10% | 0% | -4% | 3% | -1% | 3% | 1% | 2% |
| Greece | | 4% | 0% | -2% | -1% | -4% | -5% | -4% | 2% |
| Spain | | 4% | 0% | -1% | -1% | -2% | -3% | 2% | -1% |
| Finland | | 6% | 1% | -4% | 0% | 0% | 3% | 0% | -1% |
| France | | 7% | -1% | -1% | -1% | -2% | 3% | 1% | 1% |
| Ireland | | 6% | 1% | -3% | -1% | 0% | 2% | 0% | 0% |
| Italy | | 2% | -2% | 1% | -3% | -6% | 3% | 2% | 3% |
| Luxembourg | | 7% | 2% | -4% | 0% | -1% | 1% | 0% | 1% |
| The Netherlands | | 5% | 0% | -2% | 1% | 1% | 0% | 0% | 0% |
| Austria | | 2% | 1% | -4% | 0% | -2% | 2% | 3% | -2% |
| Portugal | | 5% | -4% | -1% | 1% | -4% | 0% | -3% | 4% |
| Sweden | | 4% | 3% | -2% | -1% | 1% | 1% | 0% | -1% |
| UK | | 4% | -1% | -2% | 0% | -1% | 4% | 0% | -1% |

Notes: Results in panel A are obtained by averaging the SWB across all individuals within a given country and year.

Figure A1 Sample average life satisfaction around the 2007-2008 financial crisis between treatment vs. control countries

