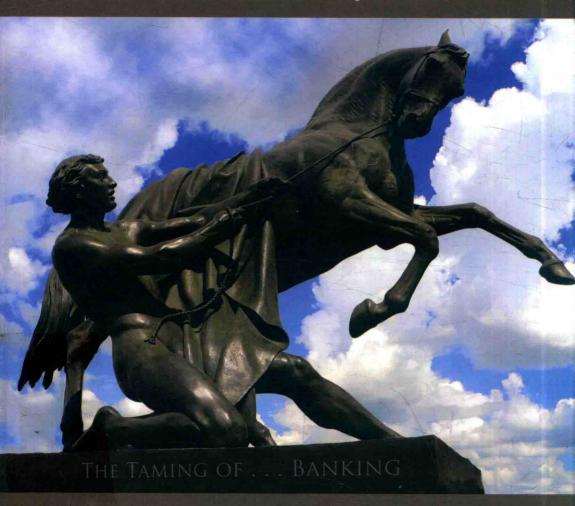
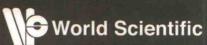
World Scientific Studies in International Economics

The New International Financial System:
Analyzing the Cumulative Impact
of Regulatory Reform

Douglas D. Evanoff, Andrew G. Haldane, and George G. Kaufman, Editors





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Editors

Douglas D. Evanoff

Federal Reserve Bank of Chicago, USA

Andrew G. Haldane

Bank of England, UK

George G. Kaufman

Loyola University Chicago, USA

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Preface

In response to the Great Financial Crisis of 2007–10, and the perceived failure of market discipline in the financial sector, government regulation of the financial system was greatly expanded and intensified. This process culminated in the United States with the enactment of the Dodd–Frank Wall Street Reform and Consumer Protection Act in July 2010. Many other countries and official international organizations enacted similar measures. What new or modified government regulations were adopted? For what purpose? What impact have they had to date or are expected to have in the near and distant future? Were the regulatory changes 'just right' or did they overshoot or undershoot the optimum target and produce suboptimal results? If suboptimal, what corrective actions may need to be taken in the future?

On November 6–7, 2014, the 17th annual International Banking Conference was held at the Federal Reserve Bank of Chicago, cosponsored by the Chicago Fed and the Bank of England, to analyze and develop answers to these and similar questions. Nearly 200 financial policymakers, regulators, and practitioners, as well as financial researchers, scholars, and academics from some 25 countries attended the two-day conference and engaged in a lively discussion. As a result, the regulatory changes and the remaining issues were clarified.

The papers presented here, as chapters, focused in turn on the near-term effects of the new regulations on financial institutions and markets, the intermediate and mostly transitional effects being observed, and the longer-term potential steady-state outcomes for both the financial and real sectors of the economy. The conference concluded with a discussion of what should be done next.

This volume contains the keynote addresses (in Part I) and the papers (subsequent chapters) delivered at the conference. The volume is intended to bring the analyses and conclusions presented at the conference to a wider audience in order to clarify and improve understanding of the issues and to stimulate further discussion aimed at guiding future financial public policy.

Acknowledgments

Both the conference held at the Federal Reserve Bank of Chicago, November 6-7, 2014, and this book represent a joint effort of the Federal Reserve Bank of Chicago and the Bank of England. Various people at each institution contributed to the effort. The editors served as the principal organizers of the conference and would like to thank all the people from both organizations who contributed their time and energy to the effort. This includes the program committee consisting of Sarah Breeden, Iain de Weymarn, Andrew Haldane and Victoria Saporta from the Bank of England; Douglas Evanoff from the Federal Reserve Bank of Chicago; and George Kaufman from Loyola University Chicago. We would also like to thank Julia Baker, Ella Dukes, Rita Molloy and Sandra Mills for support efforts. Special mention should be accorded Kathryn Moran, who managed the Chicago Fed's web effort; Sandy Schneider, who expertly managed the conference administration; John Dixon who developed the art work for both the conference program and the book cover; as well as Helen O'D. Koshy and Sheila Mangler, who had the responsibility of preparing the manuscripts for the volume.

About the Editors

Douglas D Evanoff is a vice president and senior research advisor for banking and financial institutions in the economic research department of the Federal Reserve Bank of Chicago. He serves as an advisor to senior management of the Federal Reserve System on regulatory issues and is chairman of the Federal Reserve Bank of Chicago's annual 'International Banking Conference'. Evanoff's current research interests include financial regulation, consumer credit issues, mortgage markets, bank cost and merger analysis, payments system mechanisms and credit accessibility. Prior to joining the Chicago Fed, Evanoff was a lecturer in finance at Southern Illinois University and assistant professor at St. Cloud State University. He currently is an adjunct faculty member in the School of Business at DePaul University and is associate editor of the Journal of Economics and Business and the Journal of Applied Banking and Finance. He is also an institutional director on the board of the Midwest Finance Association. His research has been published both in academic and practitioner journals including the American Economic Review, Journal of Financial Economics, Journal of Money, Credit and Banking, Journal of Financial Services Research, and the Journal of Banking and Finance, among others. He has also published in numerous books and has edited a number of books addressing issues associated with financial institutions; most recently, New Perspectives on Asset Price Bubbles (Oxford University Press), and Dodd-Frank Wall Street Reform and Consumer Protection Act (World Scientific Publishing Co Pte Ltd). He holds a PhD in economics from Southern Illinois University.

Andrew G Haldane is the Chief Economist at the Bank of England and Executive Director, Monetary Analysis and Statistics. He is a member of the Bank's Monetary Policy Committee. He also has responsibility for research and statistics across the Bank. In 2014, TIME magazine voted him one of the 100 most influential people in the world. Andrew has written extensively on domestic and international monetary and financial policy issues. He is co-founder of 'Pro Bono Economics', a charity which brokers economists into charitable projects.

George G Kaufman is the John F Smith Professor of Economics and Finance at Loyola University Chicago and a consultant to the Federal Reserve Bank of Chicago. From 1959 to 1970, he was at the Federal Reserve Bank of Chicago, and after teaching for ten years at the University of Oregon, he returned as a consultant to the Bank in 1981. He has also been a visiting professor at Stanford University, the University of California, Berkeley, and the University of Southern California, as well as a visiting scholar at the Reserve Bank of New Zealand, the Federal Reserve Bank of San Francisco, and the Office of the Comptroller of the Currency. He has also served as the deputy to the assistant secretary for economic policy at the US Department of the Treasury. He is co-editor of the Journal of Financial Stability; a founding co-editor of the Journal of Financial Services Research; past president of the Western Finance Association, Midwest Finance Association, and the North American Economics and Finance Association; presidentelect of the Western Economic Association; past director of the American Finance Association; and co-chair of the Shadow Financial Regulatory Committee. Kaufman holds a PhD in economics from the University of Iowa.

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Part I Special Addresses

Financial Entropy and the Optimality of Over-regulation

— CHAPTER 1

Alan S. Blinder
 Princeton University

Preview

One frequently hears, often as a complaint, about the financial regulatory 'pendulum' swinging too far in one direction or the other — from excessively tight regulation to excessively lax, and vice-versa. My concern in this paper is precisely with those swings. I will argue that, in fact, they may be optimal. Rather than searching for some sort of long-run equilibrium in which the marginal costs and marginal benefits of financial regulation are equated, we should expect a never-ending game of cat-and-mouse between the industry and its regulators in which first one side and then the other gains the upper hand — in a kind of cyclical equilibrium.¹

Alan Blinder is the Gordon S. Rentschler Memorial Professor of Economics and Public Affairs at Princeton University and former Vice Chairman of the Board of Governors of the Federal Reserve System. He is a co-founder and Vice Chairman of Promontory Interfinancial Network and a Senior Advisor to Promontory Financial Group. It should be noted that financial regulation affects the businesses of both of these firms. The views expressed here are his own, however, and are not shared by any institutions with which he is, or has been, affiliated. Helpful comments from a number of conference participants are acknowledged and appreciated.

¹I am hardly the first person to make such an observation. See, for example, Aizenman (2011) and, in less detail, Tirole (2014).