

The Evolution of Financial Regulation: Sufficient Change to Avoid Systemic Crises?

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“Our money, our banks, our country”
GDI, GIC and CFA Switzerland
Rüschlikon, Switzerland
5 February 2018



The role of banks prior to the crisis

- ▶ Demographics, “fall of the wall” and disinflation
- ▶ Fiat money in advanced market economies (AMEs)
- ▶ Inadequate policy resistance to banking excesses
- ▶ Rising imbalances in AME’s and crisis in 2007
- ▶ Spreading to emerging market economies (EMEs)
- ▶ And the policy makers all failed to see it coming



Post crisis regulatory reforms – good news

- ▶ More and better capital and liquidity for banks
- ▶ More attention to non-banks
- ▶ More attention to systemic risks
- ▶ Greater efforts to reduce “procyclicality”
- ▶ Agreements reached at the global level



Post crisis regulatory reforms – not good news

- ▶ Crisis management aggravated problems
- ▶ Analytical foundations of reforms questioned
- ▶ Implementation challenges
- ▶ Lobbying and innovation circumvent reforms
- ▶ “The Law of Unintended Consequences”



The need for more radical thinking about regulation?

- ▶ The need to embrace “complexity”?
- ▶ Integrating countercyclical monetary and regulatory policies ?
- ▶ Raising and simplifying capital requirements ?
- ▶ Encouraging self and market discipline?
- ▶ Changing the basic structure of the system?



Need to embrace “complexity”?

- ▶ Analytical shortcomings of economic models
- ▶ The domestic economy as a complex adaptive system
- ▶ The global economy as a complex system of complex systems
- ▶ Fundamental lessons suggested for policymakers
- ▶ The need for a “paradigm shift”



Need better integration of monetary and regulatory policies?

- ▶ Concerns to maintain agency “independence”
- ▶ Better integration in the “boom” phase?
- ▶ Better integration in the “bust” phase?
- ▶ “Lower for longer” macroprudential policies?



Need higher and simpler capital requirements?

- ▶ “Risk-weights” analytically questionable
- ▶ Banks have gamed requirements for decades
- ▶ Simple leverage ratios as an alternative?
- ▶ Need to deal with transitional problems



Need more reliance on self and market discipline

- ▶ Regulation only one of three Basel Pillars
- ▶ How might self-discipline be encouraged?
- ▶ How might market discipline be encouraged?
- ▶ Are detailed, transparent policies desirable?



Need for more radical structural change

- ▶ Lessons from other complex systems
- ▶ Roll back consolidation, globalisation and securitisation?
- ▶ “Narrow money” plus FINTECH
- ▶ Abolish financial safety nets and regulation



Concluding thoughts

- ▶ Future systemic crises are still possible
 - ▶ Every geographical region has problems
 - ▶ Problems anywhere are problems everywhere
 - ▶ Economic and financial stress also interact
 - ▶ With serious social and political implications
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- ▶ **GOOD LUCK–YOU MIGHT JUST NEED IT**

