

The Global Financial Crisis

A Crisis of the Financial System?

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LSA Toronto 9 June 2018



Financial policy during the crisis

Policy tools pushed against their technical, institutional and political bounds

- Bankruptcy resolution
- Deposit insurance
- Monetary policy
- Fiscal policy

Crises and Crises

According to Schumpeter

- A fiscal crisis is one that could be averted by better management, within the prevailing institutional bounds.
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The Global Financial Crisis (GFC)

- A financial crisis or a crisis of the financial system?

Financial Policy Since 2008

Treated largely as a financial crisis rather than as a crisis of the financial system.

New measures

- Bank resolution directive
- Macroprudential policy

Both relatively minor compared with historical responses to financial crises; historical record of these instruments is not great.

Academic consensus?

Reviewing the academic literature -- no consensus

- Financial Crisis
 - For example Blanchard et al. (2010), Mishkin (2011), Admati and Hellwig (2013)
- Crisis of the Financial System
 - For example Rajan (2010), Calomiris and Haber (2014), King (2016)

(This is our partition, these authors may not agree with it!)

Tax and financial stability

Schumpeter

“[F]iscal measures ... [contribute] directly to the construction (and distortion) of the edifice of the modern economy.”

Friedman (1962)

“[T]he major areas of governmental policy that are relevant to economic stability are monetary policy and fiscal or budgetary policy.”

Delegation of financial policy

Economists emphasise the importance of *time-inconsistency* in determining which functions of government should be delegated to independent agencies.

Short term policy goals conflict with long term policy goals (financial stability, economic growth).

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For example, the

- favourable tax treatment of debt, mortgage loan guarantees/subsidies, bank deposit levy.

View from the UK

- The current UK institutional structure deters the Financial Policy Committee (FPC) from involvement in debates over tax policy.
- This appears to result in overlapping, counteracting regulatory and tax policies.
- Also appears to reduce the willingness of the FPC to act when their actions work against tax policy.

Inevitability

Schumpeter (fn.4)

“Anyone who knows how to read in budgets and who carefully followed events in the international money markets could see the [first] world war coming for at least ten years.”

The same true for financial crises? (see Rajan 2010 for example)

Alfred Duncan and Charles Nolan. “Objectives and challenges of macroprudential policy.” Working papers, Business School - Economics, University of Glasgow, 2015.