



Financial Regulation, Supervision and Central Banking: Does Political Economy Explain It Better?

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Motivation

- Goal: “**Lead** the Discussion on the **Topic**”
presenting the State of the **Art**
- General Remarks and Specific Examples



Bottom Line

- **Topic**: Financial Regulation, Supervision and Central Banking = Institutions & policies = **RSC** variables
- The State of the **Art**:
- **Two** Approaches: Economics vs Political Economy
- **Three** Intertwined Aspects: Theory, Institutions and Empirics



Background Articles

- Financial System Risk: Taxation or Regulation?, *Journal of Banking and Finance*, 2013, (with F. Passarelli)
- The Economic Crisis: Did Financial Supervision Matter? *Journal of Financial Stability*, 2013 (with R.V. Pansini and M. Quintyn)
- Exploring Governance of the New European Banking Authority: a Case for Harmonization?, *Journal of Financial Stability*, 2011 (with Maria Nieto and Marc Quintyn).
- Reforming Financial Supervision and the Role of the Central Banks, *CEPR Policy Insight*, 2009, (with M. Quintyn)
- Politicians and Financial Supervision outside the Central Bank: Why Do They Do it?, *Journal of Financial Stability*, 2009
- Inside and outside the central bank: Independence and Accountability in Financial Supervision, *European Journal of Political Economy*. Vol. 24, n.4. 833- 848. 2008 (with M. Quintyn and M. Taylor).
- Helping Hand or Grabbing Hand? Politicians, Supervisory Regime, Financial Structure and Market View, *North American Journal of Economics and Finance*. 2008, 153-174 (with M. Quintyn).

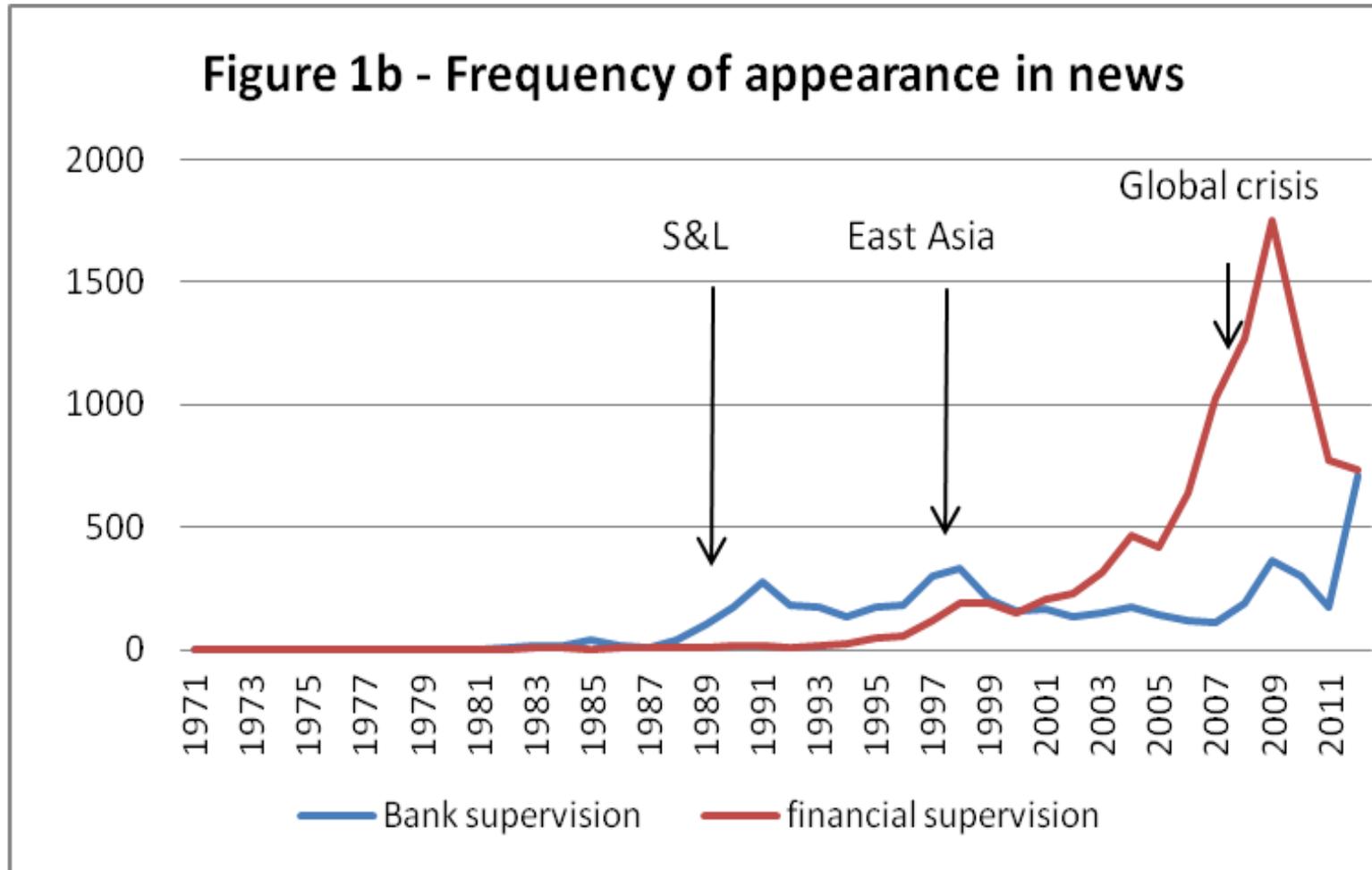


Topic

- “Conventional” Fields:
 - i) Central Banking and Monetary Policy
 - ii) Financial Regulation
- “Unconventional” Field:
 - iii) Supervision
- Driver: Light Touch Regulation Approach



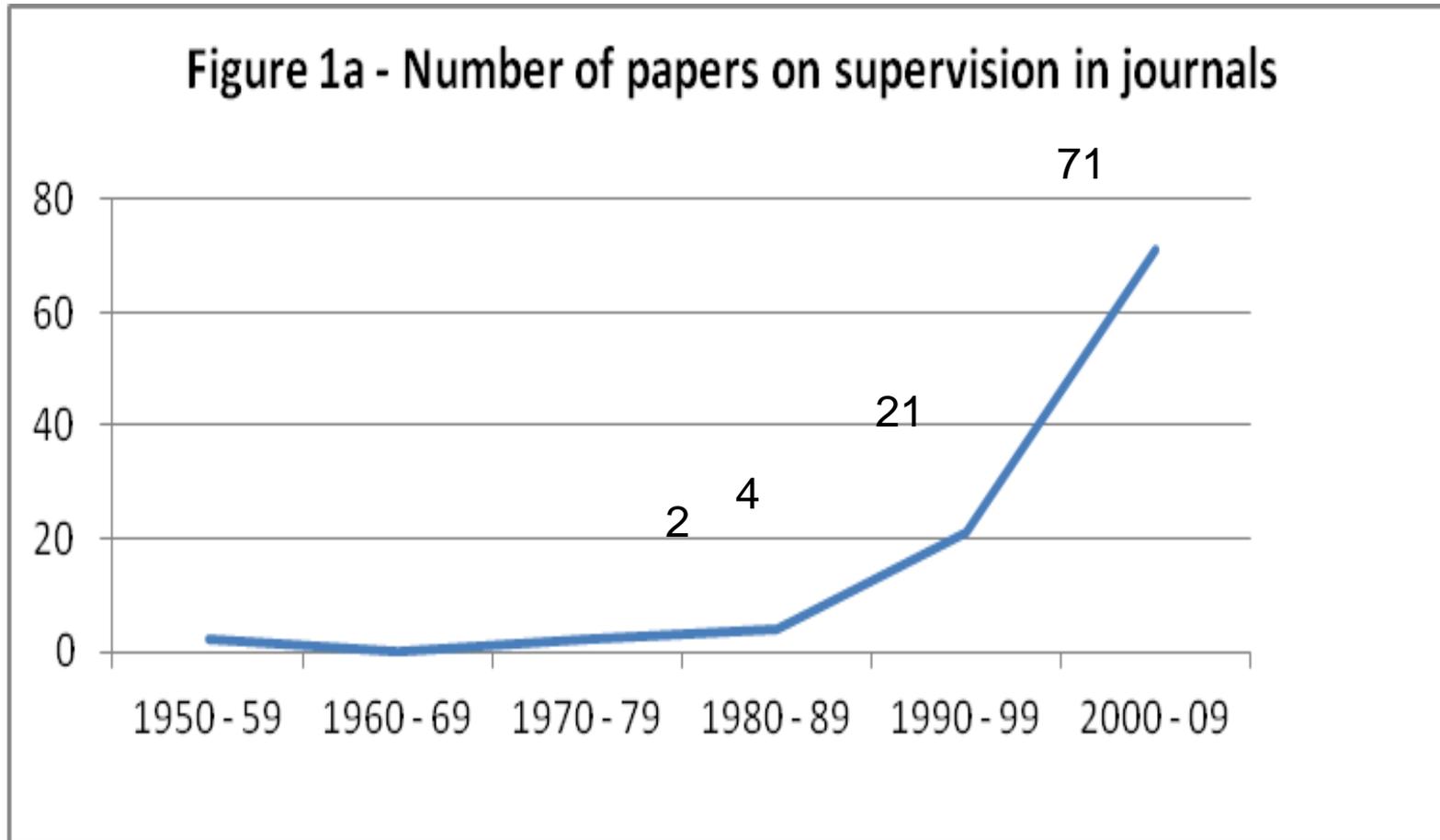
Supervision (1)



Source: Masciandaro and Quintyn 2013



Supervision (2)



Source: Masciandaro and Quintyn 2013



Economics and RSC Variables

- Given a RSC Variable:
- **Economics**: given the Social Planner, we obtain the **optimal** level of RSC*

Political Economy and RSC Variables



- **Political Economy: Two Views:**
- A) **Voter** View
- B) **Politician** View



Voter View

- Given an **heterogeneous** population of voters:
- **Result:** The **effective** level of the RSC variable can be **different** from the social optimal one
- Example: Masciandaro and Passarelli (2013)
- RSC Variable = the level of financial regulation and/or taxation against systemic risk



Politician View (1)

- Given i) a **delegation** process between citizens and public actors and ii) **heterogeneous** types of public actors
- Three Possibilities:
- **HH** Politician (career concerned player, relevant interest = median voter)
- **GH** Politician (career concerned player, relevant interest = lobby)
- **Bureaucrat** (career concerned player, relevant interest = self interest)



Politician View (2)

- **Result:** The **effective** level of the RSC variable can be **different** from the social optimal one
- Example: Masciandaro 2009:
- RSC Variable: central bank involvement in supervision
- Relevant players: HH & GH Politicians



Politician View (3)

- One **more** step: More complex delegation processes between politicians and bureaucrats:
 - 1) multi-agents delegation
 - 2) multi-principals delegation
 - 3) multi – principals and multi-agents



Politician View (4)

- Example 1: Boyer and Ponce 2012
- RSC variable : banking supervisory setting
- Relevant players: HH Politician + Bureaucrats
- Example 2: Trebbi et al. 2013
- RSC variable: regulatory policy
- Relevant players: HH & GH Politicians + Bureaucrats



Follow up: It Takes Two for a Tango

- The **endogeneity** of the RSC variables can depend on:
 - 1) Social Planner choices (**benchmark**)
 - 2) Voter choices
 - 3) Politician/Bureaucrat choices



Institutions

- **Whatever** the theoretical approach is
- It is important to **measure** the RSC variables
- In order to **test** the theory
- **Fields**: CB governance (independence, accountability), Regulatory Settings, Supervisory Architectures
- Example: Caprio's contributes on regulation and supervision



Metrics of the RSC variables

- Rules of the Games:
 - 1) Theoretical Consistency
 - 2) Information Richness
 - 3) Transparency (Replicable Results)



Empirics

- **Whatever** the RSC variable of interest is
- It can be used as:
- **Independent** variable as driver of macro performances
- **Dependent** variable to explain
- Examples: empirical literature i) on regulation ii) on central banking i) on supervision

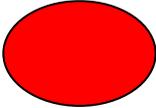
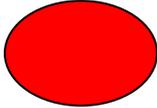
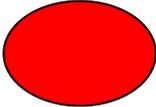


Conclusion (1)

- Political Economy Approach: Very **Promising** Methodology
- Economics and Political Economy: **Two** Sides of the Same Coin
- **Intertwined** Perspectives: Theory, Institutions and Empirics
- Graphically ...



Conclusion (2)

	Theory	Institutions	Empirics
Economics		 	
Political Economy	