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Saving the Canaries: Protecting Consumer Borrowers to Prevent Systemic Risk

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Abstract

Financial consumers are canaries in a goldmine. They are often the first who show visible signs of suffering from emerging toxic products and practices that if not suspended could spread and bring about a systemic collapse. This article considers the historical evidence linking consumer finance abuses and stressed household balance sheets with bank failures. Recently, this correlation was observed in the catastrophic global financial crisis of 2008 and related multi-trillion-dollar government intervention.

Academics often segregate studies of systemic bank failure and consumer financial predation into two separate scholarly silos. This practice may be a vestigial habit, yet at some point, passively continuing segregating these fields becomes a misguided choice. This paper posits that we must fully develop an integrated, cross-disciplinary understanding of the linkage between ballooning bank risk and household balance sheets. Until we do so, we cannot provide sound advice to policy makers on how to both protect consumers and also end the cycle of expensive public bailouts of collapsing financial institutions. Given the links, this article suggests the creation of a "Canary Index," as a way to both test household balance sheet stress and protect consumers and promote financial stability.

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