



A Macroeconomic Approach to Financial Regulation

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JOURNAL OF ECONOMIC PERSPECTIVES

VOL. 25, NO. 1, WINTER 2011

(pp. 3-28)

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Article Information

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Abstract

Many observers have argued that the regulatory framework in place prior to the global financial crisis was deficient because it was largely "microprudential" in nature. A microprudential approach is one in which regulation is partial equilibrium in its conception and aimed at preventing the costly failure of individual financial institutions. By contrast, a "macroprudential" approach recognizes the importance of general equilibrium effects, and seeks to safeguard the financial system as a whole. In the aftermath of the crisis, there seems to be agreement among both academics and policymakers that financial regulation needs to move in a macroprudential direction. In this paper, we offer a detailed vision for how a macroprudential regime might be

designed. Our prescriptions follow from a specific theory of how modern financial

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planner would have them do. Next, we

discuss a number of concrete steps to remedy these market failures. We conclude the

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paper by comparing our proposals to recent regulatory reforms in the United States and to proposed global banking reforms.

Citation

Hanson, Samuel G., Anil K. Kashyap, and Jeremy C. Stein. 2011. "A Macroprudential Approach to Financial Regulation." *Journal of Economic Perspectives*, 25 (1): 3-28.

DOI: 10.1257/jep.25.1.3

Choose Format:



JEL Classification

G21 Banks; Other Depository Institutions; Micro Finance Institutions; Mortgages

G28 Financial Institutions and Services: Government Policy and Regulation

L51 Economics of Regulation

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