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Asset-based reserve requirements: reasserting domestic monetary control in an era of financial innovation and instability

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Abstract

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Finally, t ... system of
ABRRs should be applied to all financial intermediaries.

Notes

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Having government bonds qualify would increase the demand for bonds and lower the interest rate paid by government. Qualifying bonds could be restricted to short-term issues, or could be both short-term and long-term issues.

These capital requirements were established under the 1988 Basle Capital Accords negotiation through the Bank for International Settlements.

The old system of functional regulation was another form of balance sheet regulation. Rather than linking asset and liability compositions, it prevented financial intermediaries from holding certain types of asset and liability by restricting lines of business they could enter.

This proposal has recently been advanced by D'Arista & Griffith-Jones (1998) and represents a specific application of ABRRs.

Some asset categories might be zero-rated.

The assumption of constant marginal costs means that the size of the individual firm is
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If the monetary authority is targeting the monetary base, there will be a similar effect on the structure of rates. The one difference is that the ‘general level’ of rates would shift up and down as the federal funds rate varied with fluctuations in the demand base. However, it is now widely agreed that central banks in fact target short-term interest rates and allow monetary quantities to adjust endogenously (Friedman, 2000; Goodhart, 1989; Blinder, 1998).

If investment is a positive function of consumption spending, then raising rates to dampen consumption spending will also reduce investment spending. While this is true, it remains the case that ABRR can still be used to diminish the impact of monetary policy tightening on investment spending by twisting the structure of interest rates so as to raise consumption loan interest rates and lower investment loan interest rates.

Capital requirements have allocative properties that are similar to ABRRs. Since shareholder capital is the most expensive type of capital, they tend to discourage banks from accumulating assets that carry high capital requirements. There is now discussion of making capital requirements more subject to activist discretionary change, and using them to manage the financial business cycle. Their big drawback relative to ABRRs is their pro-cyclical character.

This issue has been recently raised by Friedman (1999).
