The Daily Dish

June 8th Edition

DOUGLAS HOLTZ-EAKIN | JUNE 8, 2016

The District of Columbia joins a growing number of cities across the country raising their minimum wages. Its council members voted to approve a measure that will raise the minimum wage from $10.50 to $15.00 by 2020 and Mayor Bowser has pledged to sign it. Past AAF research shows that minimum wage proposals hurt the economy in the long run by increasing joblessness among those it's intended to help.

The American Action Forum yesterday released new research examining the impact of the fiduciary regulation on retirement savers. Specifically, the research examines how much retirement savers would lose if they are unable to roll over their 401(k)s into an Individual Retirement Account. The research finds that it would cost $1,375 per account, per year, or a total of $4.2 billion a year. Click here to view the research.

Eakinomics: Incentive-Based Regulation

Jeb Hensarling, Chairman of the House Financial Services Committee, gave an important speech yesterday, laying out his vision for an alternative approach to financial regulation. Prior to the financial crisis, prudential regulation was a crucial piece of the regulatory world. In this vision, smart regulators imposed limits on the kinds of loans and other assets that banks and other financial entities could hold, the kinds of deposits, Treasury securities, equity capital, and other liabilities that must be held, and circumscribed the markets in which they could operate. It was the conceit that smart regulators could make the world safe from financial failure.

The Dodd-Frank Act, President Obama's financial reform, doubled down on this approach to regulation. It created new regulators — the Financial Stability Oversight Council and the Consumer Financial Protection Bureau — added new kinds of regulatory tools (e.g., stress tests), changed the oversight of some markets (e.g., derivatives), micromanaged executive pay, restricted trading activities of banks (the Volcker rule), and set up an elaborate system ("living wills" and "orderly liquidation authority") to deliver failing financial institutions to regulators to be wound down. In short, it doubled down on the same regulator strategy that failed so spectacularly in the financial crisis.

Hensarling has an alternative approach. Specifically, he will focus on strong economic incentives for good behavior. There is no stronger incentive than losing one's own money, so the heart of the strategy is to encourage entities to have high levels (e.g., 10 percent) of equity capital. Those that do so would get an "off-ramp" from the Dodd-Frank supervisory regime and Basel III (international standards), would be exempted from micromanagement of dividend distributions, and provide regulatory relief for mergers and acquisitions. He would also return the disposition of failed financial firms to bankruptcy and would eliminate the notion of Systemically Important Financial Institutions (SIFIs) and the special "Orderly Liquidation Authority" that permitted the government to take over firms. Finally, he would rely on strong penalties to curb fraud and other illegal behaviors.

The Hensarling plan is a version of incentive-based regulation; i.e., don't tell a bank what to do and hope it works, rather set up incentives for banks to voluntarily manage their risks so they don't lose their own money and monitor activities so that their employees stay on the right side of the legal lines. It is a sensible approach to

produce safety and soundness, as well as a smaller and more nimble government. More details will appear in the next few weeks. It merits close attention.

From the Forum

The Cost Of Not Rolling Over 401(K)S To IRAs Because Of The Fiduciary Rule by Meghan Milloy, AAF Director of Financial Services Policy

What Critics Get Wrong On TPP by Jacqueline Varas, AAF Data Analyst

Charting Midnight Regulation Before Dawn: May Rush by Sam Batkins, AAF Director of Regulatory Policy