Journal Critique of T. Beck, R. Levine, and A. Levkov's "*Big Bad Banks?*"

<u>*Summary*</u>

Written in 2010, the three authors of "*Big Bad Banks? The Winners and Losers from Bank Deregulation in the US*" provide an analysis of the implications of bank deregulation that are debated-upon immediately post-financial crisis. Understandably, the role of banks in the financial crisis meant that many individuals were sceptical of bank deregulation. However, citing data from post-nationwide bank deregulation during the 1970s-1990s, the authors offer a sophisticated analysis whereby they find that bank deregulation benefits less wealthy individuals in the economy by reducing income inequality across the United States.

Through a series of statistical analyses of historical data, the article arrives at its main conclusion that bank deregulation does not increase banking fees and reduce economic opportunities for the poor, as critics of bank deregulation fear, but rather benefits the poor by reducing incoming inequality, as measured by the GINI coefficient. Impressively, the article is able to account for and control many external factors that could influence income inequality during this period of time, such as population growth, ethnic composition, gender job inequality, to show that there is absolute evidence for a decrease in income inequality since the time bank deregulation began to spread nationwide. To further underline that deregulation itself causes decreasing inequality, the article effectively demonstrated that inequality decreased to a greater extent in states where bank regulation was found to be most strict and had the most negative impact on bank performance prior to deregulation.

The decreasing inequality is caused by a disproportionate increase in the incomes of lower-income percentile relative to higher income percentiles.

In attempt to explain this finding, the article offered three theoretical explanations: bank regulation allowed 1. entrepreneurs of small enterprises, who tend to be less wealthy, to flourish by making microfinance easier to obtain, 2. low-income households easier access to borrow and fund education for their children, and 3. firms easier access to credit, and hence incentivizes firms to increase production and demand more low-skill labour. While all three theories seem plausible, statistics proved that it was the third theory that dominated in effect. Overall, the authors conclude by implicitly advocating for bank deregulation with the aim of further improving equality.

Evaluation and Critique

In many ways, the article provides a thorough analysis of the relationship between bank deregulation and income inequality. What the article prompts us to consider, then, is the implications of this conclusion. What the article does not answer is who the real losers from bank deregulation are. To answer this question, we need to consider whether bank deregulation's positive effects on income equality translates into improvements in economic development. Furthermore, Given that all the research data was historical, we must wonder if the same environment exists in the economy now for the same results to apply, in light of an extended long-run analysis, and in light of the post-financial crisis context. Only then can we synthesize a holistic implication of this article's findings for government policy in modern context.

The article titles "*The Winners and Loser from Bank Deregulation…"*, yet who are the actual losers? There is no clear answer from the authors. To find the costs of bank deregulation, we have to evaluate its effects on economic development, which the government might prioritize over income inequality. While reducing income equality is desirable, the end goal is often to promote development and quality of life. Associated with reducing income inequality, the article found that bank deregulation increased unskilled workers' working hours relative to that of skilled workers. While nominal returns may be greater for unskilled workers, it is uncertain whether their longer work hours really benefit their well-being and improve their quality of life. In fact, it is possible that these workers are coerced into working longer under their firms' requirements. Furthermore, the article's assertion that increased demand for labor "disproportionately on lower-skilled workers" raises the concern that perhaps decreasing income inequality is masking the fact that unskilled workers are becoming increasingly trapped in low-level jobs, thus hindering the lower class' long-term improvement prospects. If so, the decreased income inequality observed might be the first step to a greater increase in income inequality in the long run. Indeed, it is difficult to imagine that capitalists, managers, and highly-skilled workers are willing to let profits from increased production trickle-down effect disproportionately to low-level employees. In this regard, the article's conclusion that low-skill workers are the winners from bank deregulation is rather dubious.

Additionally, to holistically evaluate this article's findings' implications on policy, we need to consider bank deregulation's impacts on the rest of the economy. Basic neoclassical theory suggests that deregulation could initially spark competition between banks, but banks may eventually attempt to consolidate with other banks to gain more market share, therefore transforming the industry into an oligopoly that has unfair price setting abilities. Hence, critics of bank deregulation regularly cite concerns over "increasing banking fees and reduced economic opportunities for the poor". In light of the article's data, which spans across two decades or so, it is dubious whether the period of this data can be considered short-run data or long-run data. Deregulation across the US happened throughout 1970-1990, meaning that some data from the 1990's might actually represent the initial effects of bank deregulation if the state chose to deregulate late. In addition to the extent of legal complications and bureaucracy underlying banking, banks are likely to take long periods of time to implement changes, meaning that the article might only provide us with a short-run analysis of the consequences of bank deregulation. In fact, we have already seen bank consolidation in the past decades: the big four banks, Bank of America, Citigroup, Wells Fargo, and JP Morgan Chase, were in fact 35 separate companies in 1990 (The Motley Fool) - the onset of fully implemented nationwide bank deregulation. Precisely, this result has led to the concern of banks being too big to fail; the large and interconnected nature of these big four banks means that any of their failures would be catastrophic for the global economy. Such accumulation of risk due to bank deregulation fuels economic instability; the financial crisis proved that Benston's argument in "*What's Special About Banks?*" that the economy need not worry about bank insolvency is ill-informed in the modern era.

Some would argue that there is still a large number of banks in America, despite the big four mentioned above, meaning that there is still plenty of competition in the banking industry. However, technological advances and shadow banking developments prove to be strong forces that are making small banks, who do not have enough funds to offer the full array of services that a large banks offers, become obsolete. Hence, small banks will continuously be under pressure to consolidate with large banks. Small banks who remain independent often differentiate into boutique banks to avoid direct competition with large banks. Overall, while large banks can gain economies of scale to lower operation costs and offer wider arrays of services, we see that there is evident need to regulate, or at least monitor, the banking industry through initiatives such as the Dodd-Frank financial reform, even if economic growth may be hindered in return for stability. Alternatively, the US also needs to allow the presence of large international banks, such as HSBC, to provide competitive pressure on large American banks.

Furthermore, in light of the financial crisis, we have to question whether the theories explaining bank deregulation's positive effect on income inequality, which was derived from pre-financial crisis data, can still hold given the current economy's condition. Undoubtedly, behavioural economics plays a part in determining the economic environment post-financial crisis. With financial pessimism and conservatism pervading businesses and consumers, especially the upcoming millennials, it is doubtful whether any of the three channels by which deregulation reduces income inequality will still be as effective. Borrowing from the low-income deciles will certainly not be popular regardless how much interest rates decreases; likewise, businesses are also less likely to be as willing to take on more credit to pursue the expansion of production or increase their demand for labour. In addition, the growth of securities markets and mutual funds in recent decades provide a strong alternative source of funding for firms aside from bank loans. While these sources of funding are not as predominant as bank loans, they are likely to reduce firms' responsiveness to changes in bank loan interest rates. Summing these factors together, it is unlikely that bank deregulation will achieve anything near what the article finds from historical data. Further deregulating banks in this kind of economic environment might only work to mainly reduce large banks' obligations to act in beneficial ways to the economy.