

CURRENT SCHOLARSHIP

Why Financial Regulation Keeps Falling Short

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This article argues that there is a fundamental mismatch between the nature of finance and current approaches to financial regulation. Today's financial system is a dynamic and complex ecosystem. For these and other reasons, policy makers and market actors regularly have only a fraction of the information that may be pertinent to decisions they are making. The processes governing financial regulation, however, implicitly assume a high degree of knowability, stability, and predictability. Through two case studies and other examples, this article examines how this mismatch undermines financial stability and other policy aims. This examination further reveals that the procedural rules meant to promote accountability and legitimacy often fail to further either end. They result instead in excessive expenditures before new rules are adopted, counterproductive efforts to perfect ever more detailed rules, and too little re-evaluation of existing rules in light of new information or changed circumstances. The mismatch between the nature of finance and how finance is regulated helps to explain why financial regulation has failed in the past and why it will likely fail again. It also suggests the need for a new approach to financial regulation, one that acknowledges the limits of what can be known given the realities of today's complex and constantly evolving financial ecosystem.

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