Financial Regulation and Stability

Lessons from the Global Financial Crisis

Charles Goodhart, Emeritus Professor of Banking and Finance, and long-standing member of the Financial Markets Group, at the London School of Economics, UK and Dimitrios P. Tsomocos, Professor in Financial Economics and Fellow in Management, Said Business School and St. Edmund Hall, University of Oxford, UK

This book addresses the interaction of monetary and regulatory policy to achieve the important goal of price and financial stability. The authors show how financial stability can be assessed and measured continuously, and discuss the interrelationships between liquidity and default. Without default there would be no concern about liquidity. But the financial crisis was not just a liquidity problem, and requires a general equilibrium model. Their general equilibrium analysis demonstrates how policy should depend on understanding all the relevant factors.

‘This is a most useful book which nicely combines theory and practice. In it the authors provide a framework which helps us better understand the nature of modern financial crises and how monetary and regulatory policies interact in delivering price and financial stability. Certainly worth reading by academics, policymakers and all those interested in deepening their knowledge of how modern financial systems work in both good and bad times.’
– José Viñals, Standard Chartered, UK

‘This collection of papers is a remarkable tour de force. Goodhart and Tsomocos have made pioneering steps toward understanding the causes of financial crises and showing how the financial system can be regulated to reduce and mitigate them. A must-read for anyone interested in financial stability.’
– Doyne Farmer, University of Oxford, UK

‘Today almost everyone realizes the crucial importance of liquidity, a painful lesson taught by the global financial crisis. This collection records that Goodhart and Tsomocos were early and persistent voices, initially in the wilderness but now almost mainstream, showing the way forward by clothing old wisdom in new modelling.’
– Perry G. Mehrling, Columbia University, US

‘The 2008 global financial crisis not only damaged the world economy, it also left in the dust most of the prevailing approaches to macroeconomics. Core models which dominated the previous decades of academic research had fatally disregarded the complex workings of the financial sector. Sifting through this intellectual wreckage forms the ongoing work for the next generation of macroeconomic theorists and empiricists. Among those leading the way forward are Charles Goodhart and Dimitrios Tsomocos. This outstanding compilation of their work showcases nontrivial models of banking, well-grounded concepts of liquidity and default, and lessons for equilibrium, regulation, and monetary policy in a set of tractable and insightful frameworks.’
– Alan M. Taylor, University of California, Davis, US

‘This volume gathers in one place the key contributions of Goodhart and Tsomocos on the interplay between capital and liquidity regulations and related macroprudential tools, all in their trademark setting of a fully-fledged multi-period general equilibrium model. The command of the authors over the theory is complemented by their insightful applications of their ideas to recent events. It is required reading for theorists and practitioners alike.’
– Hyun Song Shin, Bank for International Settlements (BIS), Switzerland

‘Default plays a determining role in the operation of financial markets and the allocation of resources under uncertainty. Martin Shubik pointed out the importance of default long ago, but it is recent work, most prominently by John Geanakoplos, that has placed default in the mainstream of research. Goodhart and Tsomocos incorporate theoretical insights into operational models of monetary policy and, in particular, of financial regulation.’
– Herakles Polemarchakis, University of Warwick, UK

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