

Regulation

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REGULATION was first published in July 1977 "because the extension of regulation is piecemeal, the sources and targets diverse, the language complex and often opaque, and the volume overwhelming." REGULATION is devoted to analyzing the implications of government regulatory policy and its effects on our public and private endeavors.

Politics and Bank Regulation

I am grateful to Peter Wallison for writing his recent, provocative piece "Banking Regulation's Illusive Quest" (Spring 2007), which contains a lengthy response to an earlier article of mine in the *Yale Journal on Regulation* (Vol. 23, No. 1) called "Commercial Banking and Democracy: The Illusive Quest for Deregulation."

Unfortunately, Wallison does not really address the arguments I made in my article, because he fails to understand that my article was not about economic policy, it was about political science.

Mr. Wallison may be right that, in some alternative universe, having completely unregulated banks might be a good thing. But in the real world that we actually inhabit, politicians and regulators have taken responsibility for the safety and soundness of banks. This is fact, regardless of how much Wallison (and not very many others) wishes that it weren't. Consequently, when bank failures occur, rightly or wrongly, people blame politicians and regulators.

We live in a Darwinian political environment. If one group of politicians and regulators doesn't respond quickly and decisively to the political pressure created by a real or imagined financial "crisis," they inevitably will be replaced by another group that will. As such, we don't have the option of living in Wallison's unregulated dream world. Our real world choice is between regulation before a banking crisis arrives, or regulation later.

In point of fact, I am not, as Wallison suggests, in favor of regulation. Quite the opposite. Because I believe in markets, I favor a preventative dose of regulation now in order to avoid a much larger, perhaps toxic, dose later. History and political science both have shown that regulating earlier, before a crisis hits, leads to more moderate, more sensible, less intrusive regulation later, when there is a crisis. The horrific Sarbanes-Oxley Act is only the most recent example of how politicians and regulators do their worst when they are in a panic to respond at all.

Wallison and I don't disagree about the economics of bank regulation: we disagree about the political science of bank regulation. In a world without politics, I might join Wallison in favoring the abolition of the FDIC and the federal regulation of banks, including such things as capital requirements and, of course, federally sponsored deposit insurance. But we don't live in a world without politics.

In my view, until Wallison appreciates the environment in which regulation actually occurs, his insights on regulation will not be of great use to policy analysts or to anybody else.

JONATHAN MACEY
Yale Law School

Bank Regulation and Basel I

I thoroughly enjoyed Peter Wallison's recent article "Banking Regulation's Illusive Quest." I believe there is significant evidence, however, to support the argument that in at least one major area — bank capital regulation, as solidified by the Basel I agreement — central oversight has been extremely beneficial.

To appreciate the impact of Basel I, consider the fact that 2005 was the first year since 1962 without a single FDIC-insured bank collapse, a record which continued in 2006. In fact, the last time a bank failed in this country was June 25, 2004. By comparison, in 1989 at the height of the commercial banking crisis in the United States, 534 institutions permanently closed their doors. Even more miraculous is that this reduction occurred over a time period that included two modest recessions, which historically would have triggered many bank failures. Instead, fewer banks failed during the 1991 and 2001 recessions than in the prior non-recession years.

The increased capital requirements mandated by the 1988 Basel I accord deserve much of the credit. Realizing that adequately capitalized banks are better able to withstand losses and promote public confidence, the Group of Ten countries agreed on international capital standards for banking organizations

linked to the risk they actually face.

The greater stability that has resulted is not, as some have suggested, simply the result of strong economic performance in recent years. Rather, it is the byproduct of banks being subject to much stricter risk-sensitive capital requirements than they were prior to the Basel I agreement.

Clearly, Basel I is a case where regulation has served the banking industry well.

TOM HEALEY

Mr. Healey is a retired partner of Goldman Sachs and currently a senior fellow at Harvard University's Kennedy School of Government. He was assistant secretary of the Treasury under President Reagan

Ignoring Secondhand Smoke's Risk

Dr. Tom Lambert ("The Case against Smoking Bans," Winter 2006–2007), Dr. Gio Gori ("Stoking the Rigid Terror of Secondhand Smoke," Spring 2007), and others miss two important issues about "secondhand" cigarette smoke.

First, there is no doubt that cigarette

smoke, when inhaled, can cause cancer — 20 times the normal rate of lung cancer, and also other cancers and heart disease. When such a substance that causes human cancers is found, the usual rule in the Environmental Protection Agency is to assume a linear dose relationship and to regulate exposure until the risk is one in 1 million lifetime risk — 300,000 lower than that of cigarette smoke. I have seen no figures on how much a bystander smokes compared with a cigarette smoker, but it is hard to believe it is 300,000 times lower.

Second, in addition to the possibility of producing cancer, many people (including myself) are sensitive to smoke. Merely going into a hotel room where people have smoked and the fumes have been absorbed by the carpet is enough to make me unwell. I suffered a lot on buses, trains, and airplanes before 1985. Others are more sensitive — even someone smoking at the end of the hall drove one of my research fellows crazy. Harvard University in 1983 suggested that discussion take place between smokers and nonsmokers, "but in the case of a disagreement, the rights of non-smokers must take prece-

dence." As a department chair at the time, I asked that any nonsmoker be entitled to a room where others did not smoke, and provided extraction fans for the rooms used by smokers.

I was also asked to be on the smoking committee of the City of Newton when it enacted a similar workplace ban. One task was to discuss any disagreement between workers and employees. The only complaint came from employees of the Department of Health, one of whose bosses smoked incessantly!

In October 1869, the Board of Health of the Commonwealth of Massachusetts stated, "We believe that all citizens have an inherent right to the enjoyment of pure and uncontaminated air, and water, and soil; that this right should be regarded as belonging to the whole community, and that no one should be allowed to trespass on it by his carelessness or his avarice or even by his ignorance." This right is, in a great measure, recognized by the state as appears by the general statutes.

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