Dalit Flaiszhaker

Dalit Flaiszhaker is a Ph.D. candidate and a research fellow at the Zvi Meitar Center for Advanced Legal Studies, Tel-Aviv University, and a junior researcher in the Financial Division of the Bank of Israel Research Department. Her research focuses on the post-crisis financial regulation and its relation with the real economy. Her dissertation, written under the supervision of Prof. Roy Kreitner, analyses crucial segments of financial regulation and monetary policy, and asks how the legal framework shapes the financial system, which in turn influences the real economy.

She holds an LL.M, summa cum laude, and an LL.B, magna cum laude, from Tel-Aviv University. Her LL.M. Thesis titled "The Puzzle of Post-crisis Global Financial Regulation" examined the creation of regulation in the global level, and questioned the effectiveness of both structure and contents. Dalit received several awards, and published an article named "A Macroprudential Perspective on the EU Regulation of Money Market Funds".

Dalit has also practiced as a civil litigation attorney at leading Israeli law firms and is a member of the Israel Bar Association.

Stability and the Real Economy in Financial Regulation

In more ways than one, the recent Global Financial Crisis (GFC) was a wake-up call. It called upon regulators to recognize a new financial reality forming in front of them. Spreading to the real economy, the harsh repercussions of a financial crisis made such recognition an urgent imperative. New financial regulation attempts to respond to the challenges posed by the GFC.

This article seeks to explore how the new legal framework shapes the financial system, which in turn influences the real economy. Analyzing crucial segments of post-crisis financial regulation, the investigation will focus on the frameworks applied to banks and to shadow banks. Whereas the regulation on banks is focused on capital, liquidity and leverage limitations, the regulation on shadow banks is focused on transparency and corporate governance. In view of a potential regulatory arbitrage, differences in each sector's ability to create credit (or money) are to be expected.

In this article, it will be argued that financial regulation got it all backwards. The regulation treats the two sectors differently at the exact spots of similarity and treats them similarly at the exact spots of difference. This leads to a twofold paradoxical outcome. First, the regulation generates a re-materialization of risk in the less supervised sector, which only increases systemic risk. Second, the regulation favors the financial sector which is not necessarily the most efficient and constructive. Consequently, a further detachment of the financial system from the real economy is likely to occur, impairing equality and aggregate growth.

After describing this odd phenomenon and how it occurs, an explanation will be offered as to why it happens. Whereas stability can be used as a means to improve the financial system's provision of credit to the real economy, it should not become the "ultimate" goal of financial regulation, as currently is the case. Aimed at mere stability, regulators fall short of achieving it, but also of internalizing the legal framework's comprehensive implications. A shift of perspective from stability to a broader goal is in order. Such a shift can account for some of the actual changes experienced by the American financial system in recent years. It can also account for the normative relations between the financial system (i.e. the "market"), the law, and the real economy.