

## Interview - Thomas Hogan

Written by E-International Relations

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Dr. Thomas Hogan is a Fellow at the Baker Institute at Rice University. He was formerly the Chief Economist for the U.S. Senate Committee on Banking, Housing, & Urban Affairs. His primary research interests include banking regulation and monetary theory. Dr. Hogan was previously Assistant Professor of Finance at Troy University and Assistant Professor of Economics at West Texas A&M University. He has worked for Merrill Lynch's commodity trading group and for investment firms in the U.S. and Europe. He served as a Research Fellow at the Cato Institute and the American Institute for Economic Research and was a consultant to the World Bank. Dr. Hogan earned his Ph.D. in Economics from George Mason University and holds Bachelor's and Master's degrees in Business Administration from the University of Texas at Austin. His work has been published in academic journals such as *Economic Inquiry*, the *Journal of Regulatory Economics*, and the *Journal of Money, Credit & Banking*.

### **Where do you see the most exciting research/debates happening in your field?**

Given my own research, I am most excited about the developments in monetary economics since the 2008 financial crisis. There is renewed interest in how monetary transmission (the way money propagates through the economy) works in practice and why massive monetary injections, such as the Fed's quantitative easing (QE) programs, had such mild effects on economic activity. It took decades following the Great Depression before economists really understood its monetary causes as identified by Milton Friedman and Anna Schwartz in their 1963 book *A Monetary History of the United States, 1867-1960*. I am hopeful it will take less time for us to understand the fundamental causes of the Great Recession.

Another exciting area is the application of behavioural economics to political economy. Behavioural economists have identified a variety of ways in which human behaviours deviate from "rational" economic models. These findings are often used as justifications for government interventions in markets, but a new line of research studies how policymakers themselves exhibit the same irrational behaviours — in which case, government interventions might diminish rather than improve market outcomes. It will be interesting to see how behavioural economists react to this critique and whether it has a lasting influence on the field.

### **How has the way you understand the world changed over time, and what (who) prompted the most significant shifts in your thinking?**

My graduate studies in economics greatly influenced my thinking. Having worked in finance, I was familiar with basic economic ideas, but I learned in grad school that economic logic can be consistently and universally applied to better understand the world around me. Economics is not just used to study the stock market or gross domestic product (GDP); it is a framework for understanding human behaviour. Economics is particularly interesting because the lessons it teaches are often counter-intuitive. When people see a problem in society, they often jump to the conclusion that the government should intervene to fix it. Frequently, however, it is easy to show with simple examples that the policies they favour will cause more harm than good, either by harming the people they intend to help or by causing more harm to some other group. As a teacher, I can show people that their first instinct may not be the correct one, but they can understand the full impacts of a policy by using a little bit of economic logic.

### **What were some of your defining contributions and experiences while serving as the Chief Economist of**

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### **the US Senate Committee on Banking, Housing and Urban Affairs?**

Ironically, one of the most notable contributions during my tenure at the Banking Committee was in the area of free trade rather than financial regulation. Due to a quirk of Senate rules, the Banking Committee has jurisdiction over import-export restrictions, so proposed legislation related to trade restrictions is likely to pass through the committee. Since the 1970s, it had been illegal to export crude oil from the United States. A few years ago, this policy started to be reconsidered when a crash in the price of oil pushed many new shale oil producers to the brink of bankruptcy or beyond. In the summer of 2015, the Banking Committee held a hearing where experts testified that allowing crude oil exports would benefit both oil producers and American consumers. This, in turn, led to legislation to end the prohibition on the export of crude oil from the United States. The legislation passed at the end of 2015 and went into effect in January 2016. Opening U.S. oil markets to worldwide demand had an immediate impact on production. The International Energy Agency (IEA) recently estimated that within five years the United States will overtake Russia as the world's largest oil producer. I am proud of whatever small part I played in making that possible.

**You have stated that the Federal Reserve's regulation of US commercial banks using a system of risk-based capital (RBC) was a major contributing factor to the 2008 global financial crisis. However, the reaction to the crisis was to impose more stringent banking regulations. Have governments learnt the lessons from the financial crisis and what have been the consequences of increased banking regulation after the crisis?**

Yes, banking regulation is one of those counter-intuitive areas where people assume that more regulation is good without realizing that regulations can cause banks to take more risk rather than less. The Basel system of banking regulations is a perfect example of this. Most developed countries have adopted some form of risk-based capital (RBC) regulation based on the Basel Accords. In such a system, the regulator determines which assets are safe and which are risky, and banks are required to maintain higher capital levels if they hold more risky assets. Such a system might be effective if regulators have a perfect understanding of asset risk, but if not, it can encourage banks to increase risk. For example, if regulators underestimate the riskiness of an asset, then banks have an incentive to buy that asset, which reduces their required level of capital while increasing their level of risk.

There is now a good deal of research finding that RBC regulations did not reduce bank risk and, in fact, made financial crises worse. Papers published in a variety of academic journals, including the top journals in money and banking and monetary theory, find that simple leverage ratios are better than complex RBC ratios as predictors of bank risk. But RBC regulations were not only less effective at predicting risk, they also actively contributed to the financial crises in the U.S. and Europe. U.S. regulators encouraged banks to hold mortgage-backed securities, which were thought at the time to be quite safe. European regulators rated all sovereign debt, including Greek government bonds, as safe, risk-free assets. In retrospect, those assets were major contributing factors in the US and European financial crises, not only because they increased bank risk but also because they encouraged all banks to hold the same types of assets, thereby increasing systemic risk.

Some policymakers have come to understand the negative consequences of regulatory complexity. Thomas Hoenig and Sheila Bair, respectively the Vice Chairman and former Chair of the Federal Deposit Insurance Corporation (FDIC), have both become critics of complex RBC regulations. Recently proposed legislation from both the U.S. Senate and House of Representatives would exempt smaller banks from RBC regulations. On the other hand, many regulators continue to push for even more complex "macroprudential" regulations, with which they would manage risk not only for banks but for the entire financial system. Given their contributions to the recent crises, it seems unlikely that expanding regulators' authority would improve financial stability.

**How successful has President Trump been in fulfilling his campaign promise to lighten financial regulation?**

I would say Trump's record has been mixed so far. He has succeeded in appointing good people to many regulatory agencies, but the pace of appointments has been slower than in previous administrations. In terms of monetary policy, Trump's selection of Jerome Powell for Federal Reserve chairman is a continuation of prior Fed policies. On

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regulation, however, I think Powell is likely to favour more targeted, effective regulations rather than the avalanche of regulations we have seen from the Fed since the financial crisis. It seems like Powell, as a non-economist, is more interested in what works in practice than what only works in economic theory. I am hopeful that we will see reforms to improve financial regulations during his tenure.

Regarding his campaign promise to “repeal” the Dodd-Frank Act, the progress again is mixed. The U.S. Senate just passed a bill that addresses a few high-profile issues related to Dodd-Frank, but the reforms are less comprehensive than prior proposals in the House and Senate, and many of the institutional features of Dodd-Frank, such as the Orderly Liquidation Authority (OLA) and Consumer Financial Protection Bureau (CFPB), remain in effect. Although this bill does not really fulfil Trump’s campaign promise of repealing Dodd-Frank, Republicans will head into their midterm elections claiming this as a win, while Democrats can credibly claim to have fended off an attack on the Dodd-Frank Act.

### **Can governments effectively regulate the use of decentralized cryptocurrencies such as bitcoin?**

It would be difficult or impossible for any government to completely eliminate the use of cryptocurrencies, but many things can be done to restrict or regulate their use. Those most likely to restrict the use of cryptocurrencies are countries with a poor domestic monetary policy or a strong use of capital controls. In the last few years, China, for example, has shut down domestic bitcoin exchanges and mining operations, but cryptos are still being used for overseas transactions to evade the government’s capital controls. China has recently announced that it will use its national firewall to ban access to both foreign and domestic cryptocurrency websites, but it is unclear how effective such efforts will be in practice.

In the United States, cryptocurrencies are treated for tax purposes as investment assets, just like any foreign currency. Some cryptocurrency transaction services require a money transmitter’s license, which mandates the collection of personal information about consumers — so-called “know your customer” laws. Recently, the chairmen of the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) both argued that the U.S. should consider some form of regulation of cryptocurrency exchanges in order to protect American consumers. Such actions might benefit the industry in the short run by legitimizing cryptocurrencies in the eyes of consumers, but like most industry regulations, they are likely to create barriers to entry and entrench existing companies, making the industry less dynamic in the future.

### **President Trump has imposed new tariffs on steel imports after a complaint was lodged under Section 232 of the Trade Expansion Act of 1962. How will this move impact the US and global economy?**

I think the economic arguments for free trade are pretty clear. Trade restrictions create a net loss for the economy by benefiting a small group of producers at the expense of all consumers. There are a few theoretical cases in which trade restrictions might lead to economic gains, but none of those are likely to apply in the real world – and certainly not to a large, developed country like the United States. Because trade restrictions tend to benefit a small group at the expense of everyone else, it is easy to see how they could be used for political gain. In practice, there are only three reasons to restrict free trade: Politics, politics, and politics.

### **What is the most important advice that you would give to scholars studying the global economy?**

For students of global *anything* (business, economics, politics, etc.), I think it is important to travel abroad and get exposure to other countries and cultures. It’s one thing to read about foreign economic or political systems, but experiencing them first hand gives one a deeper and more memorable understanding. In particular, I recommend visiting countries at different levels of economic development to see how people and their local institutions address societal problems in different ways. Such exposure is, in my opinion, an important compliment to the technical expertise learned in the classroom. It won’t help you solve a mathematical equilibrium model, but it can help you understand whether your model is representative of what is happening in the real world. Some learning can only take place outside the classroom.

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*This interview was conducted by Bhargav Sriganesh. Bhargav is an Associate Features Editor at E-IR.*