Finance as a Tool to Regulate Economics

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To begin with, it is important to define what the financial system is, how it is regulated, and what its relation to regulatory economics is. So, a financial system is a set of different procedures which are implemented in order to track financial activities (Kenton, 2019). A financial system exists on a regional, local, global, and company-specific level.

The financial system is a complex structure that consists of different components depending on the level under consideration. For instance, on a regional level, the financial system helps to monitor the activity of banks, financial markets, and other institutions that provide financial services. When we are talking about the global financial system, its activity is focused on the World Bank, the International Monetary Fund, and central banks of different counties. In case one wants to understand how the financial system works within a certain company or firm, one will learn that in these cases, its primary focus will be on the revenue and expense schedules, wages, accounting measures, and balance sheet verifications.

The first and most important thing to mention is that financial regulations and rules have been created in order to keep the system safe. Yet, there are also lots of rules that are oriented on making sure that the system does crash (Allen & Gu, 2018). Even though each country has come up with its own set of financial regulations, there exists a standardized set of international banking rules called the Basel Accords. The main idea is as follows: the system is safer when banks have the opportunity to hold on to extra money which they and the country might need in case something goes wrong. Economists refer to these sums of money as reserves, and the number of reserves each country has is different. Yet, it is significant to highlight that these reserves are not “hard money.” They are kept typically in the form of assets (e.g. home loans) or government bonds.

Speaking about regulatory economics, it is the application of the law by the government of any

country in order to quickly remedy such situations as market failures, the central planning of the economy, and environmental protection. In case a situation like that occurs, the government will impose legislation on individuals and private firms to regulate and modify economic behavior.

Taking everything into account, the financial system is safer when banks have reserves—especially when the government of a country needs to act fast to regulate economic behaviors.

References

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Allen, F., & Gu, X. (2018). The Interplay between Regulations and Financial Stability. SSRN

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