THIRD WAY

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How Dodd-Frank Grows the Economy

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To improve the financial stability of the U.S. banking sector, Dodd-Frank strengthened two important regulations: risk-weighted capital and liquidity requirements. Although these rules incur some costs, the benefits of making the economy safer are much greater. In fact, risk-weighted capital and liquidity requirements benefit GDP by $351 billion in 10 years by reducing the risks of a future financial crisis.

Read our op-ed in The Hill, "How Trump can grow the economy by $351 billion".

DODD-FRANK ADDS $351 BILLION TO THE U.S. ECONOMY IN 10 YEARS

through risk-weighted capital and liquidity requirements

How: risk-weighted capital and liquidity requirements make banks take extra precautions for holding riskier assets. Banks that hold larger amounts of risky assets like subprime mortgages—as opposed to safe assets like Treasuries—must retain more capital, which is the amount by which its assets exceed its liabilities. Liquidity requirements ensure a bank's assets are easy enough to convert into cash.

There are some costs, but the benefits are much bigger:

COSTS

1. **More compliance,** like paperwork and reporting
2. **Loans become slightly more expensive,** causing lower levels of lending
3. **Output levels decrease slightly,** because lower lending reduces economic activity

reduce GDP by 0.29%

BENEFITS

1. **Lower chances of another crisis,** because banks are less likely to go broke
2. **Lower potential financial losses** in the event a crisis does occur
3. **Less havoc in the economy,** like job losses and foreclosures

raise GDP by 1.91%

Because risk-weighted capital and liquidity requirements make the financial system safer,

U.S. GDP INCREASES BY 1.62%.

For more, see: The Economic Benefits of a Stable Financial System

Source: Author's Calculations. In any year after the full implementation of Dodd-Frank, we estimate the U.S. economy is 1.62% larger with risk weights than it would be without them. Based on Basel Committee on Banking Supervision, "An assessment of the long-term economic impact of stronger capital and liquidity requirements" and "Assessment of the macroeconomic impact of higher loss absorbency for global systemically important banks," Bank for International Settlements. Concept by Emily Liner; graphic by James Decker. Free for re-use with attribution/link.

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