

CHAZEN INSTITUTE RESEARCH BRIEF

The Unintended Consequence of Basel III

KEY TAKEAWAYS

- ✓ The intention behind Basel III was to reduce systemic banking risk, but research shows such regulations mask increased risk to consumer lending and, by extension, the economy.
- ✓ Borrowers have increased their risk-taking after incurring higher loan costs as a result of Basel III.
- ✓ Since Basel III, borrowers have taken on more financial risks by concentrating sales in fewer segments and investing more in intangible assets, R&D expenditures, and capital expenditures and, thus, experienced greater volatility in performance and chance of default.

In the aftermath of the 2008 financial crisis, the Basel Committee on Bank Supervision (BCBS) instituted regulations requiring banks to maintain minimum capital and liquidity requirements. These regulations, commonly referred to as Basel III, sought to address weaknesses in the banking system exposed by the crisis and reduce the risk of widespread system failures and future economic collapses. While many agree that Basel III is making the banking industry more resilient, critics argue that it is taking a toll on the economy in the process.

In “[Risk Migration from the Banking Industry to the Real Economy: An Examination of Spillover from Basel III](#),” **Columbia Business School PhD graduate Jing Wen** investigates the effects of Basel III and reveals that it has inadvertently led to increased risk-taking by borrowers and poses a growing threat to the global economy. This paper received a 2020 Chazen Institute Doctoral Grant.

Research

The researcher compared borrowers of banks that were more affected by Basel III’s capital and liquidity requirements (i.e., banks with \$250 billion or more in total consolidated assets, which were subject to more stringent capital and liquidity requirements) with borrowers of banks that were less affected over a period of 12 years, before and after the regulations were implemented. This is the first empirical study to investigate the effects of such banking regulations on borrowers’ risk-taking.

Results

The paper provides evidence suggesting that Basel III causes risk to migrate from banks to the overall economy. Specifically, the findings show that borrowers increase their risk-taking after incurring higher borrowing costs resulting from these banking regulations. In fact, the author finds that loan costs for borrowers more affected by Basel III relatively increased post Basel III. The data also reveal that those borrowers experienced relatively greater volatility in performance and likelihood of defaulting. In particular, those borrowers increased risky investments with uncertain benefits by concentrating their sales in fewer segments and investing at higher rates in intangible assets, R&D expenditures, and capital expenditures post Basel III.

In order to prevent, or at least delay, the onset of the next financial crisis, the researcher points out that it is important for policymakers to be aware of the full extent to which borrowers' risk-taking has increased as a result of Basel III. Furthermore, Wen calls for regulators to consider ensuring that banks more carefully monitor borrower risk-taking so that unnecessary risk does not transfer to borrowers and subsequently recirculate into the banking system.

 [Download](#) the full paper.

[Learn](#) more about Chazen Institute Doctoral Grants.

[Subscribe](#) to Chazen Global Insights.

The Spillover Effects of Basel III

