

# Financial Regulation, Regulatory Arbitrage, and Gain from Policy Coordination

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## Abstract

What makes the international agreement on financial regulations important? We argue that international regulatory arbitrage, circumvention of the regulation by shifting funds to less regulated countries, prompts risk-taking behavior in relatively unregulated countries. A model is developed which captures the regulatory arbitrage by Global Investors, who conduct investment activity across borders. Based on this framework, we examine the game structure of financial regulations across countries and consider the importance of policy coordination. The model suggests that, without policy coordination, financial regulation can be harmful to each economy in terms of welfare. This result partially explains the importance of international cooperation of financial regulation.

**Keywords:** macro-prudential regulation, international coordination, international financial market

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