Efficiency, freedom, fairness, and cost/benefit analysis

Meir Statman
Glenn Klimek Professor of Finance
Santa Clara University
and Visiting Professor
Tilburg University – The Netherlands

Business Roundtable
and Chamber of Commerce
v. SEC

From the courts decision:

The Commission has a unique obligation to consider the effect of the new rule upon "efficiency, competition, and capital formation…appraise…the economic consequences of a proposed regulation"

Business Roundtable and Chamber of Commerce v. SEC

Concern that unions would impose costs on companies to benefit employees, reducing shareholder value

Business Roundtable
and Chamber of Commerce
v. SEC

Unions are one interest group, possibly shortchanging shareholders to benefit employees

Corporate executives (CEOs, members of boards) are another interest group, possibly shortchanging shareholders to benefits themselves

"Agency Conflicts" between executives and shareholders

Think of say-on-pay at Citicorp

Business Roundtable
and Chamber of Commerce
v. SEC

The Roundtable and Chamber of Commerce speak for executives (funded by shareholders)

Who speaks for shareholders?

The SEC?

George Stigler's "Capture Theory" of regulations

Interest groups, such as corporate executives or unionize employees, want more money

Politicians and regulators and want more votes and more money

Interest group organize to "capture" regulators and politicians with campaign contributions and future jobs

(Politicians choose judges)

Interest groups can do cost/benefit analysis

What about the general public?

George Stigler’s “Capture Theory” Michael Haddock and John Macey’s (1987) applications to regulations of insider trading

Two interest groups, corporate executives and Wall Street professionals, such as investment bankers

Each group is cohesive and well-organized “when compared with ordinary shareholders, not to mention the general public”

Therefore, only the interests of executives and investment bankers matter in determining regulations

If executives are prohibited from using their inside information, the group standing first in line to receive it, for free, are investment bankers

Investment bankers and other Wall Street professionals have an interest in prohibiting insider trading

George Stigler's "Capture Theory" Michael Haddock and John Macey's (1987) applications to regulations of insider trading

But what is in it for corporate executives who are now forced to give away for free their valuable inside information?

Executives are most interested in their jobs while investment professionals are most interested in inside information

Executives receive as compensation from investment bankers the benefits of the Williams Act which forces investment bankers to reveal early their hostile takeovers intentions

A bargain is struck between the two groups where each gets what is most valuable to it

But what about ordinary shareholders and the general public?

Sam Peltzman’s modification of capture theory

Ordinary shareholders and the general public can vote against “captured” politicians

This limits the power of interest groups

Sam Peltzman’s modification of capture theory

William Cary, Chairman of the SEC in 1961, ‘invented’ insider trading regulations

Cary understood the precarious position of the SEC. “Government regulatory agencies are stepchildren [of] Congress and the Executive”

Donald Langevoort: Insider trading regulation help the SEC gain visibility and support

Insider trading stories are wonderful drama: When they involve the rich and famous. They tap into images of power, greed, and hubris

Striking regulatory irons when hot

Organized interest groups strike regulatory irons most of the time

But, when enraged, the public strikes regulatory irons harder than interest groups

Think of CARD in 2009

Did credit cards have anything to do with the financial crisis?

Striking regulatory irons when hot

Signing CARD, Obama spoke about people "chocking backs tears" as they recounted credit card predicaments

Obama accused card companies of writing contracts "designed not to inform but to confuse"

Fairness and Efficiency
Fairness Rights

Freedom from coercion (Libertarian free market)

Freedom from misrepresentation (Voluntary disclosure)

Equal information (Mandatory disclosure)

Equal information processing (Paternalistic suitability regulations)

Freedom from impulse (Cooling-off-period regulations)

Equal power (Minimum wage regulations)

Recap

Corporate executives use cost/benefit arguments to benefit themselves

The public is not enraged enough to strike irons

The SEC might be captured, ineffective, or hampered by the fact that benefits are harder to measure than costs

Fairness goes beyond mandatory disclosure

How about the right to equal power?

How about serving the interests of shareholders and the general public?