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Fear and Social Capitalism: The Law and Macroeconomics of Investor Confidence

Steven A. Ramirez*

On July 9, 2002, President George W. Bush delivered a speech intended to revive investor confidence, in order to quell a rapidly declining stock market that was widely viewed as the by-product of a string of scandals in the business sector. These scandals had shaken investors' trust in the integrity of corporate America.[1] The market subsequently swooned nearly 700 points over the next forty-eight hours.[2] American capital markets were experiencing a historic crisis of confidence that was severely impacting equity prices and the availability of risk capital.[3] One measure of the extent of the crisis is that even though the economy was in the midst of a strong recovery, stock prices had plunged 20% from those prices prevailing during the economic trough; in prior recoveries prices typically climbed 20%.[4] Enron Corporation, a former darling of Wall Street and one of the largest companies in America, had evaporated seemingly overnight in late 2001, leading to the then largest bankruptcy in American history.[5] Not to be outdone, WorldCom, in early summer 2002, announced that it had overstated its earnings by some four billion dollars, and later filed a new largest bankruptcy in American history.[6] "Squeaky clean"

* Professor of Law, Washburn University School of Law. I dedicate this article to my students, and in particular the *Washburn Law Journal* Editorial Board for the 2002-03 academic year. They conceived this article before I did, in general terms at least, and I consider the solicitation to write this article a high point of my teaching career.

1. Marcia Vickers, Commentary: *Nice Speech, Mr. President, But . . .*, BUS. WK., July 22, 2002, at 37.

2. *See id.* When President Bush spoke, the Dow Jones Industrial Average was at about 9275; less than five hours later it traded at 9096. *Bush Speech Leaves Investors Wanting Action*, WALL ST. J., July 10, 2002, at C1 (stating that the Dow Jones Industrials fell 178.81 points following President Bush's speech). The next day the slide continued, virtually straight down, "like an anchor in a fishpond." Vickers, *supra* note 1, at 37. The market closed on July 10, 2002, at 8813.5, down 4.97% since the end of the Bush speech. *See* E. S. Browning, *Blue Chips Fall 3%; S&P 500 Hits 4-Year Low*, WALL ST. J., July 11, 2002, at C1 (stating that Bush's speech was the most "immediate" problem causing the Dow to skid 282.59 points). On July 11, 2002, the Dow fell an additional 208 points, before recovering in a midday surge. Peter A. McKay, *Industrials Recover From Depths Amid Late Tech Buying*, WALL ST. J., July 12, 2002, at C1. Within one week, the Dow traded over 1000 points lower than at the beginning of the Bush speech. *See* Matt Krantz, *Dow's Bounce Does Little to Dispel Fears; Analysts Hesitate to Say Markets Have Bottomed*, USA TODAY, July 16, 2002, at 1B (showing a Dow low of 8244.87 on Monday, July 15, 2002).

3. Gregory Zuckerman, *Despite Rebound, Fears of Corporate Credit Crunch Linger*, WALL ST. J., July 25, 2002, at C1 (stating that investor fears are manifest in the degree of spread between corporate debt and zero-risk U.S. Treasury obligations; investors in 2002 were demanding greater yields, thereby expanding spreads and threatening a "much-feared credit crunch").

4. Editorial, *It's Time for a New Era of Reform*, BUS. WK., July 22, 2002, at 96.

5. Brian M. Carney, *Scandals Show American Strength*, WALL ST. J., July 24, 2002, at A14 ("WorldCom's bankruptcy quickly eclipsed Enron's claim to the title of the largest bankruptcy proceeding on record.").

6. Shawn Young et al., Leading the News: *WorldCom Files for Bankruptcy*, WALL ST. J., July 22, 2002, at A3.

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Martha Stewart faced allegations of illegal insider trading.[7] Merck, Bristol-Myers Squibb, Qwest, Global Crossing, Xerox, and others each added to the drumbeat of scandals and the parade of investor losses.[8] All of this culminated in the week President Bush delivered his Tuesday morning speech; Bush's speech ushered in the worst week for the stock market since the financial nosedive that followed in the wake of the Tragedy of September 11, 2001.[9]

Bush's speech failed to quell declining investor confidence. Simply put, the capitalist class demanded more — more enforcement, more regulation, and therefore more government.[10] Responding to the demands of the capitalist class, the U.S. Senate delivered the next day, passing proposed legislation that was significantly more stringent than that proposed by the President.[11] Indeed, even Republican lawmakers quickly assumed more activist positions than that articulated by President Bush.[12] In sum, the clarion calls for reform emanated from mainstream business publications, Republican leaders, and the capitalist class itself — not the left wing.[13] Capitalists themselves wanted government intervention, and perhaps the best survey of their sentiment was the stock market decline in the wake of the President's speech.[14]

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7. Constance L. Hays, *Company Says Stewart's Woes Are Taking Toll*, N.Y. TIMES, July 25, 2002, at C1 (stating that Martha Stewart was being investigated by both Congress and the SEC).

8. *See The Unlikeliest Scourge*, ECONOMIST, July 13-19, 2002, at 22 ("A string of scandals at some of America's most high-flying firms . . . has radically changed the public mood. As investors see their portfolios shrink, venerated corporate bosses have been exposed as fraudulent hucksters."). Nor is the parade of horribles over, on July 19, 2002, Nicor, Inc. restated its earnings and disclosed accounting problems to the public. Jon Van, *Accounting Woes Fuel Nicor Stock Plunge*, CHI. TRIB., July 20, 2002, at A1. Its stock, once considered a safe haven utility issue, plunged 40% in a single trading session. *Id.* Nicor also is unlikely to be the last instance of scandal.

9. Ken Fireman, *Heard on the Street? Mixed Results After Bush Speech Seeks to Calm Consumers, Markets*, NATIONAL REVIEW, July 16, 2002, at A6. Bush gave a second speech after his July 9 speech in Birmingham, Alabama, on July 16, 2002. *Id.* Despite both speeches, the market suffered its worse two week decline since October 1987. E.S. Browning & Aaron Lucchetti, *Crash Course: Awash in Losses, Investors Look for Telltale Signs of a Bottom*, WALL ST. J., July 22, 2002, at A1 (reporting that the Dow closed at 8019.26).

10. "But more than tough talk about cleaning up misdeeds on Wall Street, investors large and small say they are waiting for concrete steps showing that Washington is serious about fighting corruption and restoring confidence in financial markets." *Bush Speech Leaves Investors Wanting Action*, *supra* note 2, at C1; *see also It's Time for a New Era of Reform*, *supra* note 4, at 96 ("[T]he President should have gone further.").

11. Shailagh Murray & John D. McKinnon, *Senate Passes Tough Fraud Bill in Unanimous Vote*, WALL ST. J., July 11, 2002, at A1 ("[L]awmakers voted 97-0 to establish sweeping new powers to target corporate fraud . . . .").

12. Jeanne Cummings & Shailagh Murray, *Hastert Backs Senate on Governance*, WALL ST. J., July 12, 2002, at A4 (stating that the Republican Speaker supports Senate bill over Bush proposals).

13. *See* Editorial, *The System Needs Fixing, Mr. President*, BUS. WK., July 15, 2002, at 148 (calling on the President to support Democratic Senator Paul Sarbanes' accounting reform bill and to consider even more radical proposals to assure operation of a "free market system" with integrity and transparency).

14. As this article goes to press, things on Wall Street have stabilized. That is wholly irrelevant to the reality that in the summer of 2002 investors were deeply shaken by the corruption in corporate America. Even if a complete meltdown in investor confidence did not take hold in the

This is hardly new. Capitalists virtually always want government intervention — albeit on their own terms — whether in the form of profit-enhancing protective regulation, subsidies, or government purchases.[15] Examples of the reality, as well as the pervasiveness of government management of the economy, are the actions taken after the events of September 11, 2001.[16] Monetary policy immediately assumed a central role in countering pervasive consumer and investor fear and became strongly stimulatory.[17] Banking regulators quickly encouraged expanded lending, even at the cost of underwriting quality.[18] Congress and the President threw a life preserver to virtually the entire airline industry with little debate or delay, guaranteeing bil-

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American capital markets, the potential now is once again a reality, not just a theoretical possibility or historical artifact. *See infra* notes 16-22, 43, 73. The crisis passed in response to sound government action. For example, the Securities and Exchange Commission (SEC) exercised its administrative authority to require Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) to certify the accuracy of financial statements at America's largest publicly held companies as of August 14, 2002. Kathryn Kranhold & Richard B. Schmitt, *Lawyers Question Order That CEOs Take Oath Over Results*, WALL ST. J., July 22, 2002, at B1 (quoting a general counsel of a large financial corporation as stating: "[t]his is a way to force a lot of companies to 'fess up and get it over with' "). This action served to reassure investors that all of the problems had been smoked out and was widely cited as a factor behind a market upswing on August 14. Michael Schroeder, *Under Gun from SEC, Bristol, Others Divulge Accounting Issues*, WALL ST. J., Aug. 15, 2002, at A1 ("[T]he deadline for certifications passed smoothly enough and the process contributed to a late stock-market rally, as investors were relieved that they didn't see any significant new bombshells bursting. The Dow Jones Industrial Average yesterday rose 260.92 points . . . to 8743.31 . . . .").

15. This point is an interesting convergence of both neo-Marxist and free market thinking. The left believes that virtually all regulation is ultimately designed for the benefit of powerful economic interests. For example, Gabriel Kolko showed that the Progressive Era of reforms was dominated by, and ultimately served, the interests of leading capitalists. *See* GABRIEL KOLKO, THE TRIUMPH OF CONSERVATISM: A REINTERPRETATION OF AMERICAN HISTORY, 1900-1916, at 3 (1963). Free marketeers, under the auspices of the Law and Economics political movement, have similarly argued that regulation is inherently self-defeating because those economic interests subject to regulation invariably exercise their economic power to control regulation politically. *See* Ronald A. Cass, *The Meaning of Liberty: Notes on Problems Within the Fraternity*, 1 NOTRE DAME J.L. ETHICS & PUB. POL'Y 777, 790 (1985) ("Take almost any government program at random, and a 'special interest' counter-majoritarian explanation can be found that is more plausible than the public interest justification for it."). I have previously shown that while a compelling argument can be made that regulation *may* be subverted by special interests, important areas of regulation can be protected from special interest influence, as exemplified by the Federal Reserve Board's (Fed) administration of monetary policy. Steven A. Ramirez, *Depoliticizing Financial Regulation,* 41 WM. & MARY L. REV. 503, 553 (2000) ("[I]mportant economic regulation can be secured against the pernicious influences of special interests.") [hereinafter Ramirez I]. Therefore, the issue on this point is not whether to regulate, but rather how to structure regulation in a way that achieves its public interest goals.

16. By the end of September, the government injected five billion dollars in cash into the airline industry and stood ready to guarantee another ten billion dollars in loans in order to stem the imminent collapse of some carriers and the cascading losses that would have hit the banking industry. Barbara A. Rehm & Laura Madaro, *U.S. Bailout for Airlines Looks Good for Lenders*, AM. BANKER, Sept. 27, 2001, at 1.

17. On September 17, 2001, the Fed cut rates for the eighth time of the year in order to stabilize financial markets worldwide. Richard W. Stevenson, *A Nation Challenged: The Federal Reserve*, N.Y. TIMES, Sept. 18, 2001, at C1.

18. On the regulatory front, "the Fed has poured billions of dollars into the banking system," and the Federal Deposit Insurance Corporation (FDIC) acted to encourage banks to take greater risks in lending to customers suffering adverse consequences from the disaster. E. Scott Reckard & James S. Granelli, *Lenders Look for Economic Equilibrium*, CHI. TRIB., Sept. 28, 2001, at C3.

lions in loans to the airlines.[19] The government stood ready for further intervention, as needed.[20] All of this was intended to stem panic: panic that was reflected in investor psychology, which by all accounts[21] had eroded to a point that had negatively and manifestly influenced stock market performance.[22] While it is true that September 11, 2001, created very unique challenges, unfettered market capitalism habitually creates unique challenges for the government and society in general.[23] Historic events seem to inexorably lead to greater government regulation and greater government presence in the so-called free market economy. The Panic of 1907 led to the formation of the Federal Reserve Board (Fed), which manages, and sometimes even micromanages, the macroeconomy;[24] the Crash of 1929 and the ensuing Great Depression led to the New Deal, which provided for wide-ranging federal regulation of financial markets, and created the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), and enhanced the power of the Fed;[25] World War II led to massive government spending, and the cold war institutionalized that spending, to the point that the federal government is now

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19. "For all the free-market talk during the campaign, this administration has excelled at forsaking sensible economics in the face of powerful special interests." *The Unlikeliest Scourge*, *supra* note 8, at 24 (listing the farm bill, trade policy, the airline bailout after September 11, 2001, and the administration's energy program as examples of the Bush administration "presid[ing] over an explosion of corporate spending").

20. Congress quickly acted to extend unemployment benefits to the ever-increasing army of laid-off employees resulting from the attack's aftermath. *See* Delroy Alexander, *Surge in Layoffs Vaults Claims to 9-Year High; Lawmakers May Extend 26-Week Limit on Benefits*, CHI. TRIB., Sept. 28, 2001, at C1. Little protest from laissez-faire enthusiasts arose in response to these actions.

21. The panic transcended borders and gripped investors world-wide. Lea Paterson et al., *London and New York Share Prices Swing Wildly*, LONDON TIMES, Sept. 22, 2001, at 56.

22. Anita Raghavan et al., *Team Effort: Banks and Regulators Drew Together to Calm Markets After Attacks*, WALL ST. J., Oct. 18, 2001, at A1 (recounting how concerted action between banks and regulators worked to quell initial panic in the financial markets).

23. Gabriel Kolko maintains that big business has used government to protect itself from the hazards of free markets since at least 1900, pursuant to a system he terms "political capitalism." KOLKO, *supra* note 15, at 3 (defining political capitalism to be the use of politics to enhance the business profits by creating a stable, predictable, and secure business environment). Economists have long rejected market fundamentalism as a viable means of operating a market-based economy. *See* JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 84-86 (2002) (showing how market fundamentalism has caused globalization to fail to achieve its promise); Robert Kuttner, *Today's Markets Need a Whole New Set of Rules*, BUS. WK., July 29, 2002, at 26 (stating that reforms designed to stem pervasive wrongdoing during the Great Depression are inadequate to stem wrongdoing today and that "laissez-faire" and "market fundamentalism" had proven once more to be a "disgrace").

24. *See* MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES 1867-1960, at 138, 153-63 (1963).

25. Steven A. Ramirez, *The Law and Macroeconomics of the New Deal at 70*, 62 MD. L. REV. (forthcoming 2003) (manuscript at 21-61, on file with author) (showing that the New Deal ushered in government's role in constructing social, regulatory, human, and physical infrastructure to unleash free markets) [hereinafter Ramirez II]. I define infrastructure broadly to include government action that either effectively lowers the cost of capital to private economic actors, or raises the effective returns to capital.

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directly responsible for 20% of the nation's Gross Domestic Product (GDP).[26]

The context in which the President spoke was similarly historic. Capital was fleeing America in the wake of revelations of widespread corruption, self-dealing, and accounting chicanery.[27] Investor confidence[28] at home had been pummeled by a historic bubble in technology shares even before the wave of scandals started dominating the front pages and broadcast media.[29] In the year prior to the President's speech, a Fortune 500 company, Enron Corporation, had essentially evaporated before the investing public's eyes, "in a sea of accounting irregularities," that wiped out over seventy billion dollars in market value.[30] But that was only the beginning. One observer estimated that in a little over two years the stock market shed $6.7 trillion in market value.[31] While consumer spending had propped up the economy, its continued vitality was deemed suspect by many experts and business investment had already suffered a potentially catastrophic decline, as investment expectations reached a historic low.[32] Thus, Bush had no choice but to attempt to revive investor confidence.

26. *Id.* at 24 n.112. All of this government intervention has led one commentator to conclude that we live in a society that is "socialism for the organized, capitalism for the unorganized," meaning that the government protects the interests of those with power, while leaving those without power to the vicissitudes of the free market. THEODORE J. LOWI, THE END OF LIBERALISM: THE SECOND REPUBLIC OF THE UNITED STATES 278-79 (2d ed. 1979).

27. *See* Edmund L. Andrews, *Turmoil at WorldCom: The Overseas Reaction; U.S. Businesses Dim as Model for Foreigners*, N.Y. TIMES, June 27, 2002, at A1 (reporting the lowest level of the dollar, as compared to the euro, in twenty-eight months); Barbara Hagenbaugh, *Foreign Investors Shun U.S. Stocks; Choosing Bonds Bad for Business, Good for Consumers*, USA TODAY, July 19, 2002, at 1B (stating that foreign investors were decelerating the rate of net stock purchases).

28. Some pundits contend that factors other than investor confidence caused the slide. However, all economic data was positive during the plunge. *See* James C. Cooper & Kathleen Madigan, *Don't Blame the Economy for the Bear Market: Blinded by Corporate Scandals, Investors Are Ignoring Good News*, BUS. WK., July 29, 2002, at 29. Moreover, the decline was stemmed on July 24, when the Dow closed up nearly 500 points; this reversal transpired after the announcement of the first high-profile arrests and congressional action to toughen securities laws. Chris Gessel, *The Big Picture: Record Volume Drives Big Upturn on Major Indexes*, INVESTORS BUS. DAILY, July 25, 2002, at B2 ("[N]ews of a congressional deal on corporate reform seemed to shift the mood from fear to hope."); *Moneyline News Hour With Lou Dobbs* (CNN television broadcast, July 24, 2002), *available at* 2002 WL 6611149 (stating that the market responded to congressional action and the fact that the "government finally went after the bad guys").

29. *See* Anthony Bianco, *The Angry Markets*, BUS. WK., July 29, 2002, at 32 (discussing impact of the litany of scandals starting in late 2001 with Enron, and continuing through midsummer with WorldCom).

30. Bruce Nussbaum, Commentary, *Beyond Enron: Don't Be So Fast to Knock U.S. Economy*, Bus. Wk., Feb. 18, 2002, at 42 (discussing malaise hanging over American business as a result of Enron and the tarnish left on the American system as a result of the scandal).

31. Gretchen Morgenson, *Wary Eye on Wall St. and Washington*, N.Y. TIMES, July 21, 2002, at A1.

32. *Id.* (quoting an economist as stating that stock market declines "will impact aggregate demand in a way that has not been seen since the 1930s"); *see also* Anna Bernasek, *Is This Where the Economy is Headed?*, FORTUNE, Sept. 2, 2002, at 85 (showing dual decline of consumer spending and business investment spending).

This article argues that in a modern economic system, law must take fear as a given.[33] The issue in financial regulation is not whether fear is rational or irrational, but whether the financial system can be protected from fear (rational or not) and whether investor psychology can be managed in a way that allows markets to allocate investment capital in a more macro-economically[34] beneficial way.[35] Indeed, fear management is a central value of the role law plays in securing a more stable and powerful macroeconomy.[36] This article seeks to articulate a comprehensive vision of how law can protect investor confidence in a way that unleashes the power of free markets to the maximum ex-

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33. In this respect, this article is fundamentally distinguishable from Professor Moran's piece, which is the lead article in this issue. *See* Rachel Moran, *Fear Unbound: A Reply to Professor Sunstein*, 42 WASHBURN L.J. 1, 1 (2002) (responding to Cass Sunstein's working paper that argues that fear should be discounted in formulating law and policy, by arguing that both scientific and emotional dimensions of fear have a place in rule-making). To the extent financial regulation requires that fear be controlled in order to minimize risks to our financial system, it provides a context that supports Professor Moran's response to Professor Sunstein. In the area of financial regulation, our society simply could not afford Professor Sunstein's prescription that fear be discounted in formulating vital regulation with a macroeconomic focus.

34. Macroeconomics is concerned with the behavior of the economy as a whole — with booms and recessions, the economy's total output of goods and services, the growth of output, the rates of inflation and unemployment, the balance of payments, and exchange rates. Macroeconomics deals with both long-run economic growth and the short-run fluctuations that constitute the business cycle .... In brief, macroeconomics deals with the major economic issues and problems of the day.

RUDIGER DORNBUSCH ET AL., MACROECONOMICS 3 (8th ed. 2001).

35. Law and macroeconomics is an underdeveloped field in the study of law and economics generally. Most of the study of law and economics has been dominated by microeconomic theory, in general, and efficiency, in particular. Mark Kelman, *Could Lawyers Stop Recessions? Speculations on Law and Macroeconomics*, 45 STAN. L. REV. 1215, 1216 (1993) ("When legal scholars ... discuss the impact of economics on their understanding of law, they invariably think about microeconomics, not macroeconomics."); *see also* John J. Donohue III & Peter Siegelman, *Law and Macroeconomics: Employment Discrimination Litigation Over the Business Cycle*, 66 S. CAL. L. REV. 709, 710 (1993) ("[L]aw and macroeconomics is quite novel in the legal academic literature."). Certainly, efficient and free markets are good. And, free markets seem to be the backbone of every very productive economy with high macroeconomic growth. Nevertheless, it is clear that efficient markets, especially as defined by proponents of laissez-faire government policies, do not assure maximum economic growth or output and suffer from chronic instability. *See* John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 64-65 (2001) (stating that empirical data "does fairly suggest that securities markets cannot grow or expand to their full potential under a purely voluntary legal regime" and that mandatory law is needed to stem market "crashes").

36. Despite the central economic importance of investor confidence, most of the writing in the area of financial regulation has not focused much on either the macroeconomic goals of financial regulation, in general, or investor confidence, in particular. Rather, the bulk of legal scholarship is centered on a microeconomic analysis of investor behavior, especially on the question of whether markets are efficient (in which case regulation is supposedly not needed) or inefficient (in which case regulation is justified). *See, e.g.*, Donald Langevoort, *Taming the Animal Spirits of the Stock Market: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. (forthcoming 2002) (stating that much more work needs to be done to understand investor behavior). I am searching in this article for the financial regulatory infrastructure that yields the greatest macroeconomic growth, output, and stability, through long term maintenance of investor confidence; *see also* Marc I. Steinberg, *Curtailing Investor Protection Under the Securities Laws: Good for the Economy?*, 55 SMU L. REV. 347 (2002) (explicitly questioning whether investor protection has been so diminished as to harm the general economy); Lynn Stout, *The Investor Confidence Game*, 67 BROOK. L. REV. (forthcoming 2002) (arguing that investor confidence protections ought not to be diluted because behavioral studies show that once betrayed investor trust is difficult to reconstruct).

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tent possible, and to show the shortcomings in our current law in this regard.

The upshot of these efforts to secure investor confidence is that fear serves to move our system towards social capitalism (a system where government supervises the economy on behalf of society as a whole) and away from corporate statism (where government is used to enhance the profits of the economically powerful without regard to the public interest).[37] Paradoxically, irrational fear creates pressure towards a fully rationalized system of government economic regulation. With widespread public fear comes issue saliency. Issue saliency is the bane of special interest influence.[38] Once the fundamental reality of fear is acknowledged, then inquiry can properly focus upon stemming the negative systemic consequences of fear and the threat that widespread fear can pose to a modern economy and therefore modern society in general. From a modern macroeconomic perspective, fear can be more corrosive to macroeconomic performance than any price shock, labor stoppage, or other macroeconomically significant event. Unfettered fear is the ultimate bogeyman of a modern economy. And, a legal system that secures a high degree of investor confidence, over the long term, will invariably achieve higher levels of macroeconomic performance than systems that are deficient on this score. Thus, the key issue in financial regulation is whether the law can create bulwarks to protect the economy from fear — not whether fear should be dealt with in a technocratic or populist fashion.[39]

John Maynard Keynes long ago recognized that "animal spirits" are the core instincts that move markets to expand — and to contract if those spirits become gripped by fear.[40] Human psychology, operat-

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37. It can safely be stated that the societies that operate a government-supervised and government-managed free market system are the most macroeconomically successful. Thus, capitalism is no longer an accurate description of most of the world's economies; unlike the period before 1932, virtually all world economies operate under a politically-negotiated system of social control of a free market system. *See* RALPH T. BYRNS & GERALD W. STONE, ECONOMICS 50-57 (6th ed. 1995) (stating that "pure capitalism" implies that governments only secure property rights and enforce contracts and that most economies are "mixed economies"). I call this form of economic system social capitalism. *See id.* at 54-55 (discussing process of convergence among the world's economic systems). To the extent major elements of this social control are hijacked by narrow special interests, then the control is exercised not for social purposes, but rather for organized economic interests — usually corporations. I call this form of a government-supervised economic system corporate statism, to clarify that the government is used as an instrument of corporate interests. Gabriel Kolko would presumably call both dynamics "political capitalism." KOLKO, *supra* note 15.

38. Ramirez I, *supra* note 15, at 506 (stating that when the public is focused on an issue or area of regulation, special interests cannot dominate regulation, and citing Dorothy A. Brown, *The Invisibility Factor: The Limits of Public Choice Theory and Public Institutions*, 74 WASH. U. L.Q. 179, 181 (1996)).

39. Cass R. Sunstein, *The Laws of Fear* (John M. Olin Law & Econ., Working Paper No. 128, 2d Series, 2001), *at* http://www.law.uchicago.edu/Lawecon/index.html. Professor Sunstein probably did not intend to include within the scope of his thesis a circumstance where fear itself is the risk to be guarded against.

40. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY 161-62 (Prometheus Books 1997) (1936).

ing through the market mechanism, can therefore impose huge costs upon society. This singular fact is the prime source of one of the most significant economic revolutions in human history: the movement throughout the twentieth century from free market capitalism to a market based economy that is fundamentally subject to social control. The yield from this movement is a system vastly more stable and productive than was ever possible under free market capitalism.[41] Essentially, massive and continuous governmental intervention in the economy works, and socially managed capitalism has emerged as the most productive system of political economy yet.[42] Fear has been the driving force in the development of this system. This paper will demonstrate the significance of government's new role in the context of the management of investor fears and investor psychology, under the auspices of protecting investor confidence.

Part I of this article will illustrate the debilitating effects of fear on macroeconomic performance and the potential benefits available to a society that uses law to secure long term investor confidence. Part II will highlight areas where the law has lagged economic theory in creating a system designed to achieve ideal investor confidence and attempt to articulate a comprehensive system of law and macroeconomics insofar as fear management is concerned. In the end, this article attempts to show that far more important than the question of whether fear is rational or irrational, is the question of how a modern economy deals with fear that is admittedly irrational. This question is one of the bedrock principles of law and macroeconomics, and one of enduring importance.

41. PETER TEMIN, LESSONS FROM THE GREAT DEPRESSION 110 (1989) ("Free market capitalism . . . had led to disaster. Direct management of the economy could only do better."). Professor Temin, an economist, uses the term "democratic socialism" to describe the new regime. *Id.* at 133. My term for the very same phenomenon (specifically, very active government management of the macroeconomy) is "social capitalism." *See generally id.* at 97, 127, 134. The difference is not merely semantic, and likely stems from differing disciplinary perspectives provided by economics and law. First, under law, the *regulation* of business was not such that it can really be called a sharp restriction in the independence of business leaders. *Id.* at 122. Second, any understanding of the lawmaking process must account for the fact that in America laws are made by elites for elites. *Supra* note 15. So it was in the Great Depression and the New Deal. COLIN GORDON, NEW DEALS: BUSINESS, LABOR, AND POLITICS IN AMERICA, 1920-1935, at 4 (1994) ("This study contributes to a broad stream of interpretation that has stressed the primacy of business interests in the formulation of U.S. public policy and the essential conservatism of the New Deal."). In the end, the greatest beneficiaries of a government-managed macroeconomy (rather than a system of government-managed business) are business elites themselves.

42. This point is perhaps best illustrated by graphs included in the Dornbusch macro text. DORNBUSCH ET AL., *supra* note 34, at 5, 45. These graphs show inflection points in the growth rates achieved by developed capitalist economies before and after the onset of government supervision and management — growth accelerated dramatically after government increased its presence in the economy. *Id.*

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I. The Macroeonomics of Investor Confidence

In order to understand how the law has constructed bulwarks for the protection of investor confidence, and the deficiencies in our current legal structures for the protection of investor confidence, we need a model of the relationship between macroeconomic performance and investor confidence.[43] The goal in this part of the article is to construct a comprehensive macroeconomic model explaining the role of investor confidence, and the mechanisms for securing a macroeconomically beneficial level of investor confidence.[44] This will serve as a template for my assessment of where our legal system succeeds and where our system fails to appropriately secure investor confidence. In constructing this model, I rely on historical and empirical evidence of aggregate investor behavior whenever possible. I also will rely upon basic macroeconomic theory. I am not interested for purposes of this article in attempting to explain or model investor behavior for predictive purposes, or in debating whether our markets are, or are not, efficient. Instead, my position is simply this: whatever chaos motivates investors and whatever level of efficiency inheres in our financial markets, we know from history the conditions under which investors lose confidence and harm our macroeconomy, and we know from well-established theory the costs of failing to secure investor confidence.[45] By assessing what has actually occurred in the past, and its macroeconomic consequences, we can predict when financial mar-

43. There can be little doubt today about the importance of investor confidence to macroeconomic performance. Recent events in America's securities markets demonstrate this link in graphic terms. *Supra* notes 1-14. Even before the recent fear that gripped our markets in the summer of 2002, anyone with even a passing familiarity with our nation's economic history is aware that a key element of the New Deal's efforts to revive a prostrate economy was the reconstruction of investor confidence. As President Roosevelt made clear: "This proposal . . . . puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence." H. R. Rep. No. 73-85, at 2 (1933) (quoting letter from President Franklin D. Roosevelt regarding the Securities Act of 1933). The Great Depression demolished investor confidence so thoroughly that investors had "grown timid to the point of hoarding" cash. This breakdown in free, unregulated securities markets posed a historic threat to "honest enterprise" and capitalism generally. S. Rep. No. 73-47, at 1 (1933). Recently, the United States Supreme Court reaffirmed the macroeconomic importance of investor confidence as a key policy objective of the federal securities laws. *See* SEC v. Zandford, 122 S. Ct. 1899, 1903 (2002) (citing United States v. O'Hagan, 521 U.S. 642, 658 (1997); United States v. Naftalin, 441 U.S. 768, 775 (1979)).

44. Fed Chair Alan Greenspan recently attested to the importance of investor confidence to macroeconomic performance. *Federal Reserve Board's Semiannual Monetary Policy Report to the Congress: Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. (2002) (testimony of Alan Greenspan), http://www.federalreserve.gov/boarddocs/hh/2002/July/testimony.htm. Greenspan testified to Congress that although the economy was performing "remarkably well," the recent erosion in stock prices threatened the continued vitality of spending. *Id.* "[T]hose prices have fallen further . . . in part under the influence of growing concerns about corporate governance and business transparency . . . ." *Id.* Moreover, the macroeconomy still faces risks stemming from "the potential for additional revelations of corporate malfeasance." *Id.*

45. *See, e.g.*, Coffee, *supra* note 35, at 65, 69-70 (stating that Asian markets were "[d]eja vu, all over again" because of strong empirical evidence that "unregulated (or underregulated) securities markets are vulnerable to crashes").

kets become dangerous to our economic health, and we can construct legal protections to prevent recurrences.

There is another reason for my focus on history and the macroeconomic consequences of investor confidence. This is the cauldron in which the federal financial regulation, in general, and the federal securities laws, in particular, were actually conceived, and these are consequently the policy bases for regulation.[46] It was not the fact that markets were found to be inefficient or that investor behavior was somehow cognitively deficient that led to the federal role in the regulation of securities or our financial markets. Nor does market failure in a myriad of other product markets justify regulation. Informational asymmetries in the market for used cars may give rise to adverse selection that causes only inferior cars to be sold in a greatly contracted market; yet, there are no calls for any federal regulation to address this market failure.[47] The reason for federal financial regulation is macroeconomic, not microeconomic, failure.[48] Microeconomic market failure is beside the point. Even the most superficial analysis of the legislative history supports this point.[49] The Fed was created in the wake of the Panic of 1907, and the SEC was created in the wake of

46. Steven A. Ramirez, *The Professional Obligations of Securities Brokers Under Federal Law: An Antidote for Bubbles?*, 70 U. CIN. L. REV. 527, 528 (2002) (stating that the securities laws were a "key element of the New Deal effort to reconstruct investor confidence and restore macroeconomic stability and growth") [hereinafter Ramirez III].

47. *See* George Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970) (demonstrating that, because buyers have insufficient information to determine used car quality, they will pay less, and high quality cars will adversely select out of the market and into the dealership used car market leaving only lemons in the private market).

48. "It is no accident that the '34 Act was promulgated in the aftermath of the greatest [macro]economic catastrophe in U.S. history." Ramirez III, *supra* note 46, at 559 (citing 15 U.S.C. § 78b (2000), which states that the purpose of the federal securities laws is to prevent "[n]ational emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare"). In addition to the statement of legislative purpose, included within the federal securities laws, there is substantial evidence of a focus on macroeconomic aggregates like employment and levels of general economic output in the Commerce Department study undertaken pursuant to presidential directive, which ultimately became the basis of the federal securities laws. *See* Stock Exchange Regulations, Letter from the President of the United States to the Chairman of the Senate Banking and Currency Committee with an Accompanying Report Relative to Stock Exchange Regulation (1934), *reprinted in* 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, Item 16, at 3 (J.S. Ellenberger & Ellen P. Mahar eds., 1973) (stating that a "violent fall" in stock prices may increase unemployment and that "senseless speculation" can have "disastrous consequences on the whole national economy").

49. Simply stated, the legislature in the early 1930s was keenly aware of the macroeconomic instability caused by the lack of investor confidence

> unless constant extension of the legal conception of a fiduciary relationship — a guarantee of 'straight shooting' — supports the constant extension of mutual confidence which is the foundation of a maturing and complicated economic system, easy liquidity of the resources in which wealth is invested is a danger rather than a prop to the stability of that system. When everything everyone owns can be sold at once, there must be confidence not to sell. Just in proportion as it becomes more liquid and complicated, an economic system must become more moderate, more honest, and more justifiably self-trusting.

H.R. REP. NO. 73-1383, at 5 (1934). *See also supra* notes 46, 48.

the Great Depression; both of these events are notable for their macroeconomic consequences, not evidence of some flaw in the efficient market hypothesis.[50] For these reasons, my model of the role of investor confidence is driven by understanding the dynamics of macroeconomic aggregates, such as output, growth, stability, and investment, and not by an analysis of market efficiency.

In a modern capitalistic society, much depends upon people willing to part with cash in hand today, with certain purchasing power, in exchange for promises of repayment and prospects of future profits.[51] Future economic expansion depends largely on the ability of entrepreneurs to obtain funds from those with excess cash (capitalists) for investment in business enterprises.[52] Similarly, entrepreneurs must have sufficient faith in the growth of the general macroeconomy such that they are willing to assume future obligations to repay funds obtained.[53] So long as such investment transactions occur, current Gross Domestic Product (GDP) increases and the prospects for future economic growth are enhanced as increasing levels of investment presumably, or hopefully, lead to increases in worker productivity, which in turn drives future macroeconomic growth.[54] Society's interest in maximizing such transactions is thus manifest; with no investment transactions current growth will cease and future growth is compromised.[55]

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50. *Supra* notes 24-25.

51. *See* ROBERT J. GORDON, MACROECONOMICS 19, 535 (8th ed. 2000) (showing that investment is an element of Gross Domestic Product (GDP) and that the Great Depression was marked by a failure of investment). Investment during the Great Depression plummeted 80%, and the issuance of new securities virtually disappeared. *Id.*; 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 216 (3d ed. 1998) (showing that new offerings declined from $9.4 billion to $380 million, a decline of over 95%).

52. BYRNS & STONE, *supra* note 37, at 44 (stating that "new capital is a major avenue of growth" and that "consuming less than we produce is saving which allows resources to be channeled into productive investment"); DORNBUSCH ET AL., *supra* note 34, at 25 (defining investment element of GDP to be "any current activity that increases the economy's ability to produce output in the future").

53. BYRNS & STONE, *supra* note 37, at 204-07 (discussing importance of business and investor confidence in economic conditions in assuring appropriate levels of investment). *See also* TEMIN, *supra* note 41, at 104 (analyzing the causes of the Great Depression). "This analysis emphasizes the role of expectations in the beginning of economic recovery. Modern theories of the economy have brought expectations onto the stage as a lead actor, unlike their earlier position as extra or understudy." *Id.*

54. DORNBUSCH ET AL., *supra* note 34, at 47 n.4 ("Labor productivity certainly grows as a result of technical progress . . . [and] because of the accumulation of capital . . . ."); GORDON, *supra* note 51, at 311 (economic growth is a function of capital formation broadly defined; thus, investments in infrastructure, education, and research and development fuel growth) (citing Joseph E. Stiglitz, *Some Lessons From the East Asian Miracle*, 11 WORLD BANK RES. OBSERVER 151 (1996); Robert E. Hall & Charles Jones, *Why Do Some Countries Produce So Much More Output per Worker Than Others?*, 114 Q.J. ECON. 83 (1999)). Productivity is defined as "average output produced per employee or per hour." *Id.* at 4. As such, productivity is central to real economic growth. *Id.* at 287.

55. A classic example is the American economy in the 1930s. The central failure in output was investment. TEMIN, *supra* note 41, at 7, 45 (agreeing with Keynes' assessment that tight monetary policy caused a precipitous decline in investment in the late 1920s and early 1930s, as investor expectations in the continuation of the economic boom declined). However, even after expectations turned around and investment recovered, unemployment remained intractable because of the lack of investment over the four years preceding the first signs of recovery. *Id.* at

Only investment transactions seemingly have this dual macroeconomic significance.[56]

From the point of view of the capitalist-investor, these investment transactions are inherently suspect. Much can go wrong, and the capitalist has parted with money on the basis of little more than a "shoeshine and a handshake."[57] Certainly, the vast majority of such transactions are reduced to writing; however, the writing does little to insulate the capitalist from the most fundamental risks of the deal: infidelity and economic viability.[58] The recipient of the cash can abscond, the money can be pilfered or embezzled by others associated with the enterprise, gross negligence (and even negligence) can lead to tremendous losses even if the deal has sound economic fundamentals, outsiders to the transaction (lawyers, accountants, investment advisers, other third parties) can cause great loss, or the managers of the enterprise may engage in a series of transactions (compensation for the entrepreneur, or cronies, transactions in options, or insider deals)

105 ("[T]he world economy in 1933 suffered from four years of neglect. New investment had ground to a halt . . . and the capital stock had been allowed to run down. With a smaller stock of per potential worker, there were fewer job opportunities.").

56. DORNBUSCH ET AL., *supra* note 34, at 347 ("Investment is an important component of aggregate demand. Investment also increases capital, increasing the productive capacity of the economy.").

57. For example, some courts have in recent years held that securities brokers owe few, if any, real duties beyond contract. *See, e.g.,* Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. 951, 953 (E.D. Mich. 1978) (holding that broker owed only a duty to execute trades as directed, which is akin to the used car salesman's duty to execute a bill of sale). Yet, these same firms hold these salespersons out as much more to the public. See http://askmerrill.ml.com/ and http://askmerrill.ml.com/fa_front/1,,,00.html, which state that Merrill will provide the "most sophisticated wealth management solutions" through "trusted" and "trained financial professionals" to provide "tailored" advice and guidance on a myriad of issues ranging from whether one's portfolio is "tax efficient" to whether one is "on-track to retirement." I have argued against these absurd results, on the basis of macroeconomic considerations. *See* Ramirez III, *supra* note 46, at 560 (stating that the law and macroeconomics of the securities laws militates in favor of imposing professional duties upon securities brokers). Nevertheless, courts have used laissez-faire efficiency considerations to relieve brokers of the duties they willingly assume in their advertising campaigns. *See, e.g.,* Robinson v. Merrill Lynch, Pierce, Fenner & Smith, Inc. 337 F. Supp. 107, 113 (N.D. Ala. 1971) ("To make this defendant or any other broker the guardian of a customer . . . would destroy an important part of the marketplace."). Obviously, holding brokerage firms to their own marketing campaigns would not destroy the marketplace, but would instead inspire investor confidence that brokers could be relied upon and trusted, and therefore be worthy of being paid for professional advice.

58. This is roughly the approach taken in surveys of investor confidence. For example, the noted Yale economist Robert Shiller surveys investors' market expectations. *See Investor Confidence 'Unshaken,' According to New Indexes Developed by Yale Economist* (Mar. 29, 2002), *at* http://cowles.econ.yale.edu/archive/people/shiller/03-29-02-ybc.htm. The Securities Industry Association surveys investor expectations as well as investor trust in the reliability and faithfulness of the securities brokerage industry. *See Public Trust and Confidence in Securities Industry Remains Strong for Seventh Straight Year – Despite September 11 Attacks, Sharp Fall in Markets* (Nov. 8, 2001), *at* http://www.sia.com/press/html/pr_investor_survey.html. The U.S. Trust Corporation surveys very wealthy investors to determine investor market expectations and the perceived reliability and trustworthiness of corporate financial statements, analyst recommendations, managements of publicly held companies, and independent auditors. *See U.S. Trust Survey Finds Affluent Americans Now Worry Most About Negative Impact of Terrorism on Economy and Securities Markets* (June 25, 2002), *at* http://www.ustrust.com/ustrust/html/aboutUs/news/062502.htm. A comprehensive investor sentiment survey would be very helpful in assessing the state of American capital markets, and it is unfortunate that no such survey exists to guide investment decisions as well as policy choices.

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designed to enrich those other than the capitalist-investor.[59] The typical text for a law school class in business associations is a virtual "little house of horrors" for passive investors, featuring a plethora of ways for such investors to lose money.[60] Worse yet, the passive investor is at the mercy of the active manager for information; a lack of business transparency and uneven disclosure flows enhance the risks facing investors.[61] These risks are in addition to the economic risks of a venture, which in and of themselves tend to be significant. There could be an extended period of economic contraction or stagnation; changes in legal or economic environment, including technological change, regulatory change, or political change; or simply a bad business plan.[62] Given the crystal ball that is needed to quantify these risks and the history of passive capitalism, it is a wonder that any capitalist-investor would ever exchange perfectly useful and liquid green paper for potentially illiquid and perfectly useless white paper.[63]

From the point of view of the entrepreneur, there are similar issues. Once the entrepreneur-investor accepts funds from investors, the entrepreneur must reckon with the obligations that must be assumed in exchange. If the investors lose money, the active entrepre-

59. Enron investors were wiped out by hidden debts and losses and improper compensation. *Testimony of William C. Powers, Jr., Chairman of the Special Investigative Committee of the Board of Directors of Enron Corporation: Before the Senate Comm. on Commerce, Sci. and Transp.*, 107th Cong. (Feb. 12, 2002), http://commerce.senate.gov/hearings/021202powers.pdf. WorldCom investors were wiped out by more accounting shenanigans while insiders got rich. Joshua Chaffin et al., *Ex-WorldCom Chiefs Arrested*, FIN. TIMES, Aug. 2, 2002, at 1 (stating that top executives garnered over forty-nine million dollars in compensation while perpetrating a multi-billion dollar securities fraud). Adelphia investors were wiped out in a sea of corporate corruption. Andrew Ross Sorkin, *Founder of Adelphia and Two Sons Arrested*, N.Y. TIMES, July 25, 2002, at C1 ("The founder of one of the nation's largest cable companies and two of his sons were arrested . . . on charges that they looted the company . . . of more than $1 billion . . . in one of the largest cases of corporate fraud ever."). The list goes on and on.

60. *See generally* MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 65, 79, 697 (8th ed. 2001) (citing respectively Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947) (controlling shareholder attempts to expropriate the wartime value of warehoused tobacco); Page v. Page, 359 P.2d 41 (Cal. 1961) (controlling partner deprives other partner of expansion opportunity); Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928) (passive partner sues for deprivation of partnership opportunity)).

61. Fed Chairman Greenspan has testified that:

> The difficulties of judging earnings trends have been intensified by revelations of misleading accounting practices at some prominent businesses. The resulting investor skepticism about earnings reports has not only depressed the valuation of equity shares, but it also has been reportedly a factor in the rising risk spreads on corporate debt . . . further elevating the cost of capital . . . .

Greenspan, *supra* note 44, at 4. Chairman Greenspan also finds the run of corporate malfeasance "worrisome" in terms of productivity — which is central to macroeconomic growth. According to the testimony of the Fed Chair, without accurate information mis-allocations of capital can occur, undercutting the ability of investment to support productivity gains. *Id.* Thus, accurate information flow to investors is also a key element of a strong microfoundation for an economy so that capital can flow to optimal uses.

62. BYRNS & STONE, *supra* note 37, at 205-06 (stating that investments will be made if they are expected to yield returns in excess of the cost of capital, but that forecasting business conditions and changes in legal environment may make actors leery of many projects).

63. As Keynes stated: "[The urge] to do something positive . . . can only be taken as a result of animal spirits . . . and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities." KEYNES, *supra* note 40, at 161.

neur is the only one who may face a potentially costly, even ruinous, lawsuit brought by the passive investors.[64] In this respect, the entrepreneur must face more risks than merely economic risks. Traditionally, in an ordinary business context, active investors generally are only liable for gross negligence or fraud, so that the entrepreneur is ultimately in control of the vast amount of this risk.[65] Still, in any event, the active entrepreneur must reckon with the cost of capital. The higher the cost of capital, the less likely is the success of any venture, and many ventures simply become cost-prohibitive.[66] All of these issues are in addition to the risks of economic viability discussed above.[67] Entrepreneurs, too, face prodigious risks in undertaking investment activity.

So, why does such activity take place? John Maynard Keynes long ago analyzed investment conduct and came up with the most convincing explanation to date.[68] Investment activity takes place in response to "animal spirits."[69] While such an explanation is less than intellectually satisfying, it is probably true that humans are instinctively motivated to build something better, to find a better mouse trap, to exploit natural resources in a never ending-quest to better their circumstances, and the general circumstances of human existence. Avarice certainly plays a central role, but no doubt there is also a need to achieve a sense of accomplishment or the feeling of making a contribution to worthy endeavors.[70] The reasons why humans part with their cash, and why entrepreneurs attempt to put this excess cash to work, matter little in the end; what is critical from a macroeconomic point of view is that appropriate levels of investment take place. Clearly, investor confidence is key to this ideal level of investment activity.[71] With confidence that the macroeconomy is

64. Curt Cutting, *Turning Point for Rule 10b-5: Will Congressional Reforms Protect Small Corporations*, 56 OHIO ST. L.J. 555, 583 (1995) (concluding that frivolous litigation is a tax on innovation); Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 976 (1993) (concluding that securities litigation raises cost of capital).

65. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-214 (1976) (holding that defendants may only be liable under Rule 10b-5 upon a showing that they acted with an intent to deceive, manipulate, or defraud); Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (holding that directors may only be liable for misconduct amounting to gross negligence, under the business judgment rule).

66. DORNBUSCH ET AL., *supra* note 34, at 217 ("Typically firms borrow to purchase investment goods. The higher the interest rate for such borrowing, the lower the profits that firms can expect to make by borrowing to buy new machines or buildings, and therefore the less they will be willing to . . . invest.").

67. *Supra* note 62.

68. *Supra* note 63; *see also* Langevoort, *supra* note 36, at 69 ("Neither the SEC nor academics have spent enough time on detailed field studies of investor behavior, so we lack a solid sense of how decisions occur or what social dynamics are at work that might drive market prices.").

69. *See* BYRNS & STONE, *supra* note 37, at 205.

70. *Supra* note 63.

71. I assume for purposes of this article only that the economy has optimal microfoundations so that, whatever the level of investment is, capital markets allocate capital to its highest

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sound, and that they are being dealt with truthfully, investors will undertake investment even though it rests in the end upon a "wing and a prayer."[72]

From the point of view of society generally, the macroeconomic consequences of investment activity mean that society has a compelling interest in investor confidence. This compelling interest is manifested in government intervention and regulation of financial markets, as expressed through our legal system. Government can play a key role in stabilizing investor confidence in a way that supports appropriate levels of investment activity. In essence, government action can remove sources of fear, or risks, that unnecessarily inhibit the capital formation process.[73] For example, a sound system of financial regulation can optimize the ability of passive investors to obtain remedies for true claims of infidelity against active investors, while insulating, to the maximum extent possible, entrepreneurs from the prospect of

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and best use. *See* Langevoort, *supra* note 36, at 2 (summarizing the efficient market hypothesis). Of course, if all investors had perfect information they would never lose money, and there would be only one security per given duration.

72. I draw a distinction between risks of infidelity between the passive investor and the active investor, and the risk of market infidelity. For example, the insider trading prohibition is central to investors' confidence that the securities market is fair and not rigged in favor of insiders. United States v. O'Hagan, 521 U.S. 642, 658 (1997) (upholding the misappropriation theory of insider trading under the Securities Exchange Act of 1934, in part because "an animating purpose of the Exchange Act [is] to insure honest securities markets and thereby promote investor confidence"). A similar prop to market integrity is antitrust law. Arguably, antitrust law should function to protect active investors from being denied real market accessibility through the economic oppression of those with monopoly power. *See generally* LAWRENCE SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK § 1.5b3 (2000) ("By the end of the twentieth century, there was no longer (if there ever was) a right of a displaced competitor to claim that the displacement in and of itself was grounds for antitrust relief."). Nevertheless, the real focus of antitrust law is the maintenance of competitive markets — in other words the primary goal is securing appropriate microfoundations for the economy, not macroeconomic growth. E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 1 (1994) ("Antitrust is the study of competition. It is a body of law that seeks to assure competitive markets through the interaction of sellers and buyers in the dynamic process of exchange."). As a result of its present focus on microfoundations for the economy, antitrust law is beyond the scope of this article.

73. The Fed has clearly entered the fear-management business. For example, after September 11, 2001, the Fed acted to stem investor panic relating to the prospects for an economy persistently plagued by terrorism. *Supra* notes 16-22. In 1987, when Greenspan was the brand new Fed Chairman, he acted aggressively to quell investor fear in the wake of the 1987 market break — which culminated in the Dow shedding 508 points on October 19, 1987 (a loss of 22.6% of its value) — by flooding the financial markets with liquidity and encouraging higher volumes of lending. JUSTIN MARTIN, GREENSPAN: THE MAN BEHIND MONEY 174-79 (2001). In 1997, the Fed had to come to the rescue of the markets again: the so-called "Asian Contagion" had toppled powerful economies across Asia and into Russia. By 1998, burned investors were in a full-fledged "flight to quality" — buying up zero-risk U.S. Treasury obligations but fleeing anything more risky, including U.S. corporate bonds. As investor confidence sagged, a recession loomed. The Fed responded with a series of interest rate cuts and public statements showing it was on the beat and participated in assembling a syndicate of private financial firms to bail out a prominent victim of the carnage — a hedge fund known as Long Term Capital Management. This all served to resolve the crisis. *Id.* at xii-xviii. So, basically the Fed is the world's chief financial firefighter. Performing this function quells investor fears and lowers the cost of capital, as investors need not worry (too much at least) that a catastrophic meltdown will cause a major macroeconomic disruption.

baseless claims.[74] The ability of the legal system to reconcile these apparently competing interests will impact the cost of capital in two ways. First, by limiting the fear of infidelity (through compensation and deterrence), passive investors will part with their excess cash at a lower cost to entrepreneurs relative to a legal system that fails to appropriately quell such fears, and adequately secure this element of investor confidence.[75] Second, by eliminating, to the maximum extent possible, frivolous lawsuits, entrepreneurs will be willing to undertake the economic risks of pursuing investment opportunities at a lower cost.[76] This will effectively lower the cost of capital, thereby spurring more investment transactions that can potentially spur productivity gains.[77] Therefore, government can provide an appropriate system of substantive law and dispute resolution for investor claims that can balance these fears in a way that maximizes economic growth.[78]

Government can also provide a safe haven for temporary cash reserves by creating a zero-risk vehicle that can be widely used for funds that will soon be deployed to meet expenses or pending alternative investments. Such a vehicle would assure that all funds would be productively deployed to the maximum extent possible and few pools of cash (other than, literally, pocket change) would lie idle.[79] In addition, public confidence in bank deposits would be maximized and this confidence would lower the cost of capital.[80] This is achieved through deposit insurance, in which the government guarantees that bank deposits will be paid on demand.[81] Of course, in order to contain the costs associated with deposit insurance, particularly the costs implicit

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74. Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727, 728 (1995) (stating that correct policy response is to search for a means of screening out frivolous claims while allowing meritorious claims to survive).

75. *See* 1 LOSS & SELIGMAN, *supra* note 51, at 217-18 (3d ed. 1998) (stating that enhanced investor confidence will lower risk premia demanded by investors and benefit both entrepreneurs as well as investors).

76. *Supra* note 64.

77. *Supra* note 54.

78. *Supra* note 61.

79. *See* FDIC v. Phila. Gear Corp., 476 U.S. 426, 432-33 (1986) (stating that the FDIC was created in the face of "an extraordinary financial crisis" where a "vast sum of assets and purchasing power [was] tied up" by panicked depositors unwilling to part with "hard earnings" after more than one-third of the nation's banks failed over a four year period) (quoting S. REP. NO. 73-77, at 12 (1933) (emphasis omitted)).

80. Helen Garten, *Still Banking on the Market: A Comment on the Failure of Market Discipline,* 5 YALE J. ON REG. 241, 250 n.40 (1988) ("The goal of maintaining public confidence is based on the need to promote the stability of the banking system.").

81. [T]he purpose of this legislation is to protect the people of the United States in the right to have banks in which their deposits will be safe. They have a right to expect of Congress the establishment and maintenance of a system of banks in the United States where citizens may place their hard earnings with reasonable expectation of being able to get them out again upon demand . . . . [T]he purpose of the bill is to ensure that the community is saved from the shock of a bank failure. . . . The public . . . demand of you and me that we provide a banking system worthy of this great Nation and banks in which citizens may place the fruits of their toil and know that a deposit slip in return for their hard earnings will be as safe as a Government bond.

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in the moral hazard[82] of allowing the government to foot the bill of excessively risky banking, regulation is needed.[83] However, it is impossible to conceive of a modern scheme of protecting investor confidence without the presence of some form of deposit insurance.[84] Otherwise, fearful citizens would too often forego the banking system and find alternatives to bank deposits for their excess cash, rather than expose their funds to some degree of repayment risk or incur the costs associated with investigating various banking enterprises.[85] Reassuring citizens that the money they deposit in the banking system will be paid upon demand effectively abolishes bank runs, which contract the money supply, disrupt the lending process, and thereby stunt macroeconomic performance.[86] Of course, once government undertakes to guarantee virtually all of the liabilities of banks (deposits are the main liability of most banks) a central part of the so-called free

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7 CONG. REC. 3837, 3838, 3840 (1933) (remarks of Rep. Steagall). Deposit insurance was one part of the massive banking act passed during the first 100 days of the New Deal. *See* Banking Act of 1933, ch. 89, § 8, 48 Stat. 162, 168 (codified as amended at 12 U.S.C. §§ 1811-1832 (1994)).

82. Moral hazard results when one party (here, a bank manager) can impose costs on another party (the bank insurance fund) by undertaking conduct (like risky lending) because of lack of monitoring and control mechanisms (like sound bank regulation). A bank manager facing insolvency has everything to gain and nothing to lose from risky loans. If the loans repay at high interest, perhaps the bank can be saved; but it is no big deal if the loans default because the deposit insurer, not the manager, will repay depositors. *See* BYRNS & STONE, *supra* note 37, at 480-82.

83. For example, I have previously argued that bank directors and managers should be held to a more demanding standard of care, given the critical role they play in the capital formation process, the fact that bank failures or bank losses can lead to credit crunch, the fact that the government subsidizes their operation by guaranteeing their deposits, and the fact that when they fail it is the government that must bail them out. Steven A. Ramirez, *The Chaos of 12 U.S.C. Section 1821(k): Congressional Subsidizing of Negligent Bank Directors and Officers?*, 65 FORDHAM L. REV. 625 (1996). The U.S. Supreme Court essentially disagrees. *See* Atherton v. FDIC, 513 U.S. 213, 225 (1997) (holding that there is no federal common law negligence standard for federally insured bank directors, because of insufficient federal interest, despite the fact that the U.S. government paid hundreds of billions of dollars to cleanup the savings and loan crisis of the 1980s).

84. *See* Curtis J. Milhaupt, *Japan's Experience With Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?*, 77 WASH. U. L.Q. 399, 430 (1999) ("Bank losses are quasi-fiscal deficits around the world; bank distress invites extensive government intervention everywhere. Put this way, deposit insurance looks more promising than the real world alternative — a safety net operated at the discretion of political agents.").

85. *See* Kenneth E. Scott & Thomas Mayer, *Risk and Regulation in Banking: Some Proposals for Federal Deposit Insurance Reform*, 23 STAN. L. REV. 857, 860 (1971) ("The only practicable way the small depositor can find out that a depository institution is unsafe is to have it suspend payment, and by that time it is too late . . . ."). Depositors cannot detect frauds or evaluate financial information at a reasonable cost. *Id.*

86. Laurie S. Goodman & Sherrill Shaffer, *The Economics of Deposit Insurance: A Critical Evaluation of Proposed Reforms*, 2 YALE J. ON REG. 145, 146 (1984) ("The major justification for a deposit insurance system operated by the federal government rests on macroeconomic grounds: Deposit insurance acts as a stabilizer by preventing bank runs and the dangerous reduction in the nation's money supply that large-scale bank failures can cause."); GORDON, *supra* note 51, at 231 (explaining the causes of the Great Depression and concluding that "after September 1931, the [macroeconomic] contraction was caused by monetary factors, including the enormous loss of lifetime savings in bank failures"). Of course, microeconomic theory stresses that depositors would rationally act to discipline excessive riskiness in banking by monitoring their bank's financial circumstances and either negotiating protective contract provisions, demanding higher interest payments, or withdrawing their money. *See* Jonathan R. Macey & Elizabeth H. Garrett, *Market Discipline by Depositors: A Summary of the Theoretical and Empirical Arguments*, 5 YALE J. ON REG. 215, 239 (1988).

market system perishes; deposit insurance means that every bank is subsidized by the government and that the government has an unlimited negative equity interest in every single bank.[87] Thus, deposit insurance lowers the cost of capital for banks, and therefore bank borrowers, and lessens the likelihood of macroeconomic shocks from a spate of bank failures; each of these consequences leads to more investment.[88]

Monetary policy[89] is crucial to investor confidence at two basic levels. First, nations that enjoy a depoliticized monetary authority are likely to enjoy a more sound currency.[90] A sound currency will remove the fear of runaway future inflation thereby lowering inflationary expectations and helping to lower inflation premia in investment transactions.[91] Second, a credible monetary authority can use monetary policy to cushion macroeconomic shocks and stabilize macroeconomic performance.[92] The risk of severe economic downturns is thus minimized. This results in lower economic risks for all investment transactions and an accordingly lower cost of capital.[93] In addition, a strong monetary authority can respond to asset bubbles[94] in a way that can minimize their potential to cause macroeconomic harm. Thus, legal structures to support a depoliticized monetary authority are fundamental macroeconomic infrastructure.[95]

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87. *See* Joseph A. Grundfest, *Lobbying Into Limbo: The Political Ecology of the Savings and Loan Crisis,* 2 STAN. L. & POL'Y REV. 25, 32 (1990) (referring to deposit insurance and stating "few industries have been able to persuade Congress to bankroll them to the tune of up to $500 billion").

88. *See* GORDON, *supra* note 51, at 430 (stating that before deposit insurance bank runs caused a contraction of the money supply as depositors demanded cash, and as banks accumulated additional reserves to guard against panicked depositors); Robert E. Krainer, *Banking in a Theory of the Business Cycle: A Model and Critique of the Basle Accord on Risk-Based Capital Requirements for Banks*, 21 INT'L REV. L. & ECON. 413, 426 (2002) (stating that "deposit insurance provides an important subsidy to the loan customers of banks" because banks can obtain funds at a zero-risk rate, to be used to finance a risky loan portfolio).

89. Monetary policy is the use of government control over "the money supply and interest rates" to influence macroeconomic aggregates such as unemployment, inflation, or growth. GORDON, *supra* note 51, at 22.

90. ROSA MARÍA LASTRA, CENTRAL BANKING AND BANKING REGULATION 13-18 (1996) (summarizing empirical data).

91. DORNBUSCH ET AL., *supra* note 34, at 329 (showing that inflationary expectations impact the cost of capital).

92. *Supra* notes 17-18, 73.

93. *See* BYRNS & STONE, *supra* note 37, at 205 (stating that business expectations are central to investment and as the economy strengthens, investment grows). Keynes stated that the "spontaneous optimism" that supports investment activity rests upon a "delicate balance" that is "excessively dependent" on a "congenial environment" including economic prospects, legal context, and even the weather. KEYNES, *supra* note 40, at 62.

94. An asset bubble "generally refers to a situation in which prices greatly exceed the real economic value of an asset" class. Ramirez III, *supra* note 46, at 561 n.216.

95. Jerry L. Jordan, *Hayekian Economic Infrastructure as a Foundation for Sustained Prosperity,* 19 CONTEMP. ECON. POL'Y 20, 26 (2001) (stating that "economic infrastructure plays a major role in determining economic prosperity" and that the ideal infrastructure includes a credible monetary authority).

Similarly, fiscal policy[96] can be used to quell investor fears and stimulate investment. When governments deploy fiscal policy in a counter-cyclical fashion, they can manage their budgets to lessen economic manias and to prevent economic slow-downs before they devolve into depressions.[97] In an ideal world, fiscal policy can further enhance macroeconomic performance beyond just the benefits yielded by stabilization activities. Adam Smith long ago suggested that government should properly make investments in infrastructure where aggregate benefits greatly exceed aggregate costs, but benefits are so diffused throughout the economy that no private economic actor is capable of capturing sufficient benefits to justify absorbing all of the costs associated with such an investment.[98] Frequently such investments can spur gains in productivity that justify the government use of capital.[99] Again, when government pursues this function in a counter-cyclical fashion, it can slash its own cost of capital, as well as slashing economic pessimism among investors.[100] The net effect is both enhancing long term economic prospects and eliminating, to the extent possible, the fear of severe economic downturns. Both of these effects enhance investor confidence and maximize investment activity. Government sponsored investment in infrastructure can also minimize political risks as well as create and maintain a level of demand that supplies enough consumption to help even marginal economic ventures succeed.[101] The New Deal was in essence the first concerted effort by the American government to fund investments in physical, social, and human infrastructure with a view to enhancing long term macroeconomic stability and performance.[102] In terms of investor confidence specifically, fiscal policy can stabilize macroeconomic performance by quelling investor fears of a major macroeconomic disruption and can enhance macroeconomic growth by performing the function of investor of last resort, which will effectively enhance investor expectations.

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96. Fiscal policy is the use of government control over expenditures and tax policies to influence macroeconomic aggregates such as unemployment, inflation, or growth. GORDON, *supra* note 51, at 22.

97. For a short history of the triumphs and tribulations of a politicized fiscal policy function in the U.S., see BYRNS & STONE, *supra* note 37, at 125-30.

98. ADAM SMITH, WEALTH OF NATIONS 473 (Prometheus Books 1991) (1776) (stating that government is duty bound to provide "public institutions" and "public works" which may be "in the highest degree advantageous to a great society" but which are not profitable to any individual economic actor because of diffusion of benefits).

99. To the extent government can productively add to a nation's productive capital, growth will result. *Supra* note 53.

100. Fiscal policy is most effective precisely when confidence is at a low ebb. As expectations falter, interest rates decline and can even go so low that the economy approaches a liquidity trap, where investment is not prompted by lower interest rates. *See* DORNBUSCH ET AL., *supra* note 34, at 245. It is in this context that fiscal policy has its greatest influence on output while crowding out private investment the least. *Id.* at 251.

101. Ramirez II, *supra* note 25 (manuscript at 39-40).

102. *See generally id.*

Monetary policy alone cannot provide these benefits. Economists have recognized that in some scenarios monetary policy may fail to revive economic prospects.[103] No matter how low interest rates sink, if widespread economic fear grips a society then no investors will be willing to take the risks that their ventures will succeed.[104] The case of Japan since 1989 abundantly proves that even very low interest rates may be ineffective in preventing or short circuiting economic recessions.[105] Interest rates cannot realistically go below zero; and to the extent they do reach such depressed levels they are emblematic of extreme economic pessimism.[106] A negative interest rate means investors are so gripped by economic fear, that they are contented just to get most of their money back, and they do not really expect entrepreneurs to find profitable uses for cash.[107] Government sponsored investments, on the other hand, directly stimulate an economy, even in the face of very low economic expectations, which may render monetary policy impotent.[108]

Princeton economist Paul Krugman has been a leader in the field in identifying and assessing the consequences of monetary policy impotence.[109] For example, Krugman posited that contemporary Japan has been mired in a "liquidity trap" throughout the 1990s and continuing through today.[110] According to Krugman, an economy with "poor

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103. When actors are exceedingly pessimistic about economic prospects, an expansive monetary policy fails to lead to output gains because both consumption and investment are stilted by the belief that prices will decline if expenditures are deferred. Or, investors can become so risk averse that money balances remain high despite interest rate cuts. In such a context, monetary policy can become impotent, or in a well-known vernacular, trying to stimulate an economy through monetary policy alone can be like "pushing on a string." GORDON, *supra* note 51, at 127-28, 135-38, 224-33, 581-84. Thus, monetary policy cannot always be a trusted means to stem economic instability.

104. BYRNS & STONE, *supra* note 37, at 309-10.

105. GORDON, *supra* note 51, at 135-38.

106. Interest rates declined to below 1% in both Japan after 1995 and in the U.S. after 1931; in neither case was this low interest rate able to revive economic growth. *See* GORDON, *supra* note 51, at 136.

107. Keynes recognized that in the U.S. in 1932 investors would not part with cash "on any reasonable terms." KEYNES, *supra* note 40, at 207-08. Usually such sentiment follows a burst asset bubble, as investors fear further risk.

108. *See* BYRNS & STONE, *supra* note 37, at 209-13 (showing government expenditures to be an element of GDP).

109. Krugman's work on Japan's monetary impotence set off a cascade of economic diagnostic work regarding Japan. *See* Paul Krugman, *Japan's Trap* (May 1998), *at* http://web.mit.edu/krugman/www/japtrap.html (last visited on Aug. 1, 2002) [hereinafter Krugman I]. Krugman formalized his Internet posting later in 1998. *See* Paul Krugman, *It's Baaack: Japan's Slump and the Return of the Liquidity Trap*, 2 BROOKINGS PAPERS ON ECON. ACTIVITY 137 (1998). The basic problem in Japan during the 1990s (and continuing through today) is that deflationary pressures became so great that even interest rates that were virtually zero (two-year government bonds yielded only .48% in mid-1999) failed to revive investor expectations and thereby spark economic growth. *See* Michael Hutchison, *Japan's Recession: Is the Liquidity Trap Back?*, FED. RES. BANK S.F. ECON. LETTER, June 16, 2000, at 2 (responding to Krugman's theory that Japan was suffering from a liquidity trap with evidence that it was instead suffering from a credit crunch).

110. Paul Krugman, *Japan: Still Trapped, at* http://web.mit.edu/krugman/www/japtrap2.html (last visited Aug. 18, 2002) [hereinafter Krugman II].

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long run growth prospects" can suffer from investor confidence that is so low (because of built-in expectations of deflation)[111] that "monetary expansion, *no matter how large,* is ineffective."[112] Therefore, saving exceeds investment, as pessimistic savers keep cash instead of investing.[113] The leading alternative view is that the ineffectiveness of monetary policy in Japan is due to a "credit crunch."[114] This explanation holds that a contraction in the supply of bank credit neutralizes expansionary monetary policy.[115] The contraction can be for any number of reasons including: a high volume of non-performing loans that can compromise bank capital and lead to restricted lending; the need to raise capital ratios that can cause banks to be conservative lenders as high risk loans place more capital at risk; and slow macroeconomic growth, bankruptcies, and non-performing loans that can make lenders pessimistic about repayment prospects causing them to be more stringent in lending money.[116] In the end, whether termed a credit crunch or a liquidity trap, economic pessimism (investment expectations and lending attitudes) compromises the capital formation process leading to a decline in investment even in an expansionary monetary environment.[117] For purposes of this article, it matters not whether Japan is in a liquidity trap or a credit crunch; the challenge here for law and macroeconomics is to insure that economists and policymakers have the full panoply of weaponry at their disposal in attacking declining investor confidence.[118] What is important is this:

111. In a deflationary context, expectations will encourage consumers and investors to refrain from making expenditures in the hope that waiting will result in lower prices. Thus, investment and consumption are suppressed, as expenditures are increasingly deferred based upon increasingly more powerful deflationary expectations. As lower growth, or even negative growth, becomes the norm, investors will naturally adopt lower profit expectations leading to foregone investment, and consumers will respond by curtailing expenditures to save for hard times ahead. Moreover, consumers and investors will borrow less, because they will face the prospect of having to repay loans with more valuable dollars than they borrowed, as prices deflate and dollars buy more. Lenders will lend less, because they will adopt more pessimistic outlooks on future profitability. It is not a pretty picture. *See* TEMIN, *supra* note 41, at 59.

112. Krugman I, *supra* note 109, at 2.

113. *See* Hutchison, *supra* note 109, at 1.

114. *Id.* at 2.

115. *Id.*

116. *See* Ben S. Bernanke, *Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression*, 73 AM. ECON. REV. 257 (1983) (discussing lack of lending enthusiasm during the Great Depression due to bank failures); Joe Peek & Eric Rosengren, *The Capital Crunch: Neither a Borrower Nor a Lender Be*, 27 J. MONEY, CREDIT & BANKING 625 (1995) (discussing credit crunch during 1990s due to heavy loan losses and the unwillingness and inability of banks to lend).

117. DORNBUSCH ET AL., *supra* note 34, at 245-48 (discussing factors that cause lenders not to lend because of risk aversion); Hutchison, *supra* note 109, at 2 (stating that "massive nonperforming loans accumulating in the financial system" can cause banks to refrain from lending).

118. Japan's malady illustrates the compelling stakes of this issue. First, the depth of Japan's malaise is huge. Krugman argues that Japan's macroeconomic performance in the 1990s, compared to a Japan that experienced moderate growth of just 2%, implies a huge amount of foregone output, with significant consequences not just to Japan but the entire global economic system. Second, once a full blown deflationary cycle grips an economy it is very difficult to shake it off. Not just monetary impotence, but fiscal impotence, has stricken Japan. The Japanese government now runs deficits as high as 10% of its GDP, and its debt has been downgraded

lack of investor confidence is central to the creation of conditions necessary for either credit crunches or liquidity traps; such macroeconomic phenomena are certainly not rare, and both are extremely dangerous.[119]

Investor confidence is not all about stimulating investment in order to achieve high levels of macroeconomic output. Sometimes investor confidence can be too strong and devolve into a mania that produces asset bubbles.[120] This in turn produces snake-bit investors, who are unnecessarily risk averse — giving rise to a negative bubble of pessimism run amok.[121] Since World War II, western capitalism has been plagued by a series of asset bubbles that ultimately leave the capital formation process permanently scarred.[122] To an extent, bubbles can be stemmed through appropriate fiscal and monetary policy restraint, or targeted restriction of credit sources that fuel bubbles.[123] Bubbles can also be mitigated by requiring investment advisers to conduct themselves in accordance with high standards of professionalism.[124] However, it could well be that in a fully globalized economy capital will naturally flow to the most promising investment opportunity, causing currency distortions that feedback into the target asset's valuation, and giving rise to serial bubbles through out the world economy.[125] Until full economic development becomes more global-

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in quality so that it must pay higher interest to fund its deficits. This dual monetary and fiscal impotence leaves very limited macroeconomic policy latitude. *See* Krugman II, *supra* note 110, at 1, 5.

119. In addition to Japan, in the U.S. a credit crunch/liquidity trap (i.e., monetary impotence) at least exacerbated the Great Depression in the 1930s. GORDON, *supra* note 51, at 136. In the early 1990s, the U.S. experienced a mild credit crunch, which neutralized monetary policy. DORNBUSCH ET AL., *supra* note 34, at 245-48. More recently, fears are growing that in 2002, the U.S. is facing a growing credit crunch/liquidity trap. *Supra* note 3.

120. Neoclassical theory does not explain well the instances of irrational investor exuberance that periodically grip asset markets again and again. *See* CHARLES P. KINDLEBERGER, MANIAS, PANICS AND CRASHES: A HISTORY OF FINANCIAL CRISES 220-21 (4th ed. 2000) ("Dismissing financial crisis on the grounds that bubbles and bust cannot take place because that would imply irrationality is to ignore a condition for the sake of a theory.").

121. Economist Robert Shiller concludes that the U.S. may be perilously close to a negative bubble. D.C. Denison, *WorldCom on the Brink: Economists See 'Negative' Bubble,* BOS. GLOBE, June 27, 2002, at C1 (quoting Shiller and reporting that the Index of Investor Optimism is at an historic low).

122. The so-called Asian Contagion, the Japanese malady, and the Great Depression each started with an asset bubble. *See generally* ROBERT J. SHILLER, IRRATIONAL EXUBERANCE 129, 222-24 (2000).

123. The Fed tried to manage the stock market bubble of the late 1990s by jawboning the market down — most famously when Fed Chair Alan Greenspan questioned whether "irrational exuberance" had gripped the equity markets. *See* MARTIN, *supra* note 73, at 214-17.

124. Ramirez III, *supra* note 46, at 562-63 ("[T]he proposal for a more professionalized securities brokerage industry would serve to stem 'mass psychology' at the source; professional brokers would be widely available to investors who have 'no special knowledge' and 'mass psychology' would be more informed.") (citing KEYNES, *supra* note 40, at 153-55)). Upon reflection, this proposal to give meaning to the federal effort to professionalize the securities industry would effectively raise the market IQ of equity markets.

125. This is a scary thought, in that it implies that the globalized economy may be rigged towards bubbles. Commentators have suggested, for example, that the Japanese bubble of the late 1980s may well have been triggered by the U.S. market crash of 1987. The subsequent market crash in Japan certainly created an additional relative allure for the U.S. market in the

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ized, bubbles seem to be part of the landscape.[126] Ultimately, it may take an international accord or authority to stem this long running and pernicious cycle.

Globalization poses new challenges to investor confidence, but also provides new opportunities for nations to learn from each other the best means of achieving an ideal regime of law and macroeconomics for securing an optimal level of investor confidence.[127] Globalization means that any flaws in a nation's legally constructed system of supporting investor confidence can have amplified adverse consequences. Capital flows to a nation with inferior mechanisms for maintaining investor confidence will suffer.[128] Consequently, the nation's currency will erode in value, causing further capital flight.[129] Thus, both foreign and domestic investment will decline at the same time that an eroding currency creates inflationary

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1990s, particularly after the Asian Contagion in 1997, when the U.S. was apparently the most lucrative place to invest. *See* Shane Walton, *East Asia, 1997: Avoidable or Inevitable?*, *at* http://www.siue.edu/EASTASIA/walton_1001.htm (last visited Oct. 23, 2002) (stating that "over-liquidity" and wild swings in investor confidence predispose international finance to "large, erratic and potentially dangerous surges" in investment that can devastate regional economies through rapid capital flight). It seems as though there is too much money sloshing around the globe, literally bouncing from bubble to bubble. *See also* SHILLER, *supra* note 122, at 118 ("[S]peculative bubbles — periods of exaggerated but temporary investor enthusiasm, often associated with 'new era' theories — are in fact commonplace.").

126. Professor Shiller argues that "broadening of markets by encouraging global participation . . . should often have the effect of averaging over . . . disparate expectations and producing more stable market[s]." SHILLER, *supra* note 122, at 228. The latest candidate for a potential asset bubble is the U.S. real estate market. *See* Motoko Rich, *The Housing Bubble Loses Some Air*, WALL ST. J., Aug. 1, 2002, at D1.

127. This process is well underway. For example, the Asian Corporate Governance Association exists to show companies in the Pacific Rim that sound corporate governance leads to a healthier business environment. "Higher levels of transparency and accountability bring easier access to international capital markets, and help to minimise both risk and the cost of capital." ASIAN CORPORATE GOVERNANCE ASSOCIATION, BUILDING STRONGER BOARDS AND COMPANIES IN ASIA: A CONSISE REPORT ON CORPORATE GOVERNENCE POLICIES AND PRACTICES 45 (2000). The Association is specifically acting in response to the fact that "increasing integration of the world economy is intensifying the pressure" towards uniform and real measures to enhance investor confidence. *Id.* As the Global Corporate Governance Forum has stated:

> Good governance is a source of competitive advantage and critical to economic and social progress. In an increasingly globalized economy, firms need to tap domestic and international capital markets for investment. But capital providers have choice — and the quality of corporate governance is increasingly becoming a criterion for investment and lending.

Corporate Governance: An Issue for International Concern, *available at* http://www.gcgf.org/about.htm (last visited on Aug. 17, 2002). These international organizations define corporate governance broadly; "Corporate governance is concerned with the systems of law, regulation, and practice which will promote enterprise and ensure accountability." *Id.* This definition is broad enough to encompass the props to investor confidence discussed in this article.

128. The U.S. faced this very prospect in early to mid 2002. The trade-weighted value of the dollar fell 9% from February, 2002 to July, 2002, as foreign securities purchasers found American securities less attractive and pulled their funds out of the U.S. James C. Cooper & Kathleen Madigan, *Corporate Crime Isn't Fazing Consumers, Yet*, BUS. WK., July 22, 2002, at 23. "This is the most pessimistic sentiment against the United States that I have ever experienced in my career. . . .There is unanimous agreement that the U.S. is not the best place to invest anymore," said Wolfram Gerdes, chief investment officer for global equities at Dresdner Investment Trust in Frankfurt, Germany. Edmund L. Andrews, *U.S. Businesses Dim as Models for Foreigners*, N.Y. TIMES, June 27, 2002, at A1 (reporting the lowest level of the dollar, as compared to the euro, in twenty-eight months).

129. Andrews, *supra* note 27, at A1.

pressures.[130] Inflation is a threat to capital formation because both passive investors and active investors must be compensated for the effects and risks of eroding currency.[131]

Therefore, globalization, with increasing economic integration and free flowing capital, creates competition among nations to achieve ideal regimes of legally protected investor confidence. The nation that achieves the best system of investor protection will attract more capital at a lower cost — this translates into a powerful competitive advantage.[132] Globalization also presents an opportunity to observe competing mechanisms for fostering investor confidence in action. An alert governing elite should pay attention to laws across nations and should emulate those that work the best.[133] Over the long term, this should prove to be a benefit of globalization.

The upshot of this is that the macroeconomic stakes of preserving investor confidence are higher than ever. A legal system that can preserve investor confidence will support higher levels of macroeconomic performance. Moreover, a successful system of market-based capitalism will take steps to assure a stable and low cost source of funds to fund business expansion on an ongoing basis. In the end, the viability of free markets to deliver as promised is premised upon the viability of continued investment transactions, notwithstanding the fact that investment activity is effectively founded upon a "shoeshine and a handshake" as well as a "wing and a prayer."[134]

Each of the bulwarks of investor confidence and fear management that I have addressed implies a highly interventionist federal government, one that is at odds with most scholars' views on the proper role of government in the field of law and economics.[135] Nevertheless, this intervention is simply a fact of life in a modern market-based economy.[136] Macroeconomic prospects depend upon such government intervention — and this realization is the central blind spot of the law and economics movement. For example, scholars in law and economics have done little work showing why a depoliticized

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130. *See id.*

131. Inflation inevitably leads to higher real interest rates (as monetary policy restraint sets in), which in turn diminishes the volume of investment that can be profitably undertaken. *See* DORNBUSCH ET AL., *supra* note 34, at 259-60 ("Over the period 1981-1984 the real interest rate increased sharply even as the nominal rate declined" and investment fell in part because of high real borrowing rates.); GORDON, *supra* note 51, at 528.

132. *Supra* notes 27, 30.

133. The Asian Corporate Governance Association was founded by a group of nine business leaders from seven leading Asian economies. ASIAN CORPORATE GOVERNANCE ASSOCIATION, *supra* note 127, at 45, 47.

134. *Supra* notes 57, 72.

135. Law and economics is dominated by political distaste of government action. *See, e.g.*, Langevoort, *supra* note 36, at 68 (hoping that research emerges showing market efficiency so that we can be "rescued" from further regulation, because unregulated markets are "politically more palatable").

136. *Supra* notes 16-22, 24-26.

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monetary authority is needed or why it is so beneficial.[137] Yet, economists certainly understand how critical such an authority is to the functioning of our economy.[138] Rather than confronting the hard reality that asset bubbles are real and commonplace in a globalized economy,[139] the law and economics movement largely denies that such bubbles exist.[140] There are a host of other areas of law and regulation where the traditional canon of law and economics fails to address macroeconomic concerns, even though such concerns are central to purposes of such areas.[141] Perhaps the crisis of investor confidence that gripped the U.S. in the summer of 2002 can at least serve as a platform for ushering macroeconomic concerns to center stage of future policy debates in appropriate circumstances.

Recently, the consequences of a breakdown in this government sponsored effort to enhance investor confidence, and to quell fears of fraud, manipulation, and insider advantage, have become manifest.[142] In late 2001, one of the largest publicly held corporations, Enron, failed and sought refuge in bankruptcy. At the same time, the telecommunications bubble burst, like the internet bubble the year before. Global Crossing failed shortly after Enron, and in early 2002 WorldCom filed the nation's largest bankruptcy ever.[143] All of this took a terrible toll on investor confidence.[144] The market woefully

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137. Even though the Fed is the central economic actor in the world, the law and economics movement has had precious little to say about its structure and its implications generally for financial regulation. *See* Ramirez I, *supra* note 15, at 518-20 (articulating five-factor test for agency independence and reviewing reasons for the Fed's depoliticized structure).

138. *Supra* note 95.

139. *Supra* notes 120-22.

140. *See* RICHARD POSNER, ECONOMIC ANALYSIS OF LAW § 15.8 (5th ed. 1998) (stating that the stock market crash anticipated the Great Depression). Posner's conclusion flies in the face of mainstream economics. First, there were no models extant in 1929 for predicting the Great Depression because no such economic catastrophe had ever happened before. Richard Layard, *Foreword* to TEMIN, *supra* note 41, at x-xi ("Expectations were not 'rational' in the modern sense because the Depression was a new phenomenon and the economic models to explain were in their infancy. We need to be wary of policies made today that assume that policymakers and investors understand more than they actually do."). As Professor Temin has stated: "None of the policymakers, none of the investors, none of the consumers, had ever lived through a depression like this before. The annals of economic history did not contain a similar event." *Id.* at 86. Professor Temin specifically denies that there is any basis for concluding that the stock market was capable of prognosticating the Depression. *See id.* at 57-59 (stating that although some fear of some inflation may have caused some repricing of the stock market, even modern statistical tools and databases, unavailable in the 1920s and 1930s, "did not suggest that the good times had ended"). Second, prominent economists, such as Robert Shiller, now widely believe the stock market of the late 1920s was an asset bubble. *See* SHILLER, *supra* note 122, at 9, 188, 222-23 ("[W]e know that the run-up in the stock market from 1920 to 1929 was a colossal mistake and that the drop from 1929 to 1932 was another colossal mistake.").

141. *Supra* notes 86, 95, 99.

142. *Supra* notes 1-14.

143. *Supra* note 6.

144. For example, the June 25, 2002, survey of very wealthy investors sponsored by the U.S. Trust Company found that 76% of these investors did not trust corporate financial statements, 58% questioned auditor independence, and 66% did not trust management. U.S. Trust Survey, *supra* note 58, at 2. One commentator stated that the "destruction of investor confidence, of this magnitude, hasn't occurred in roughly 70 years." Brian Kelleher, *Wall Street Scrambles to Burnish Tarnished Image*, REUTERS COMPANY NEWS, June 26, 2002, at 1.

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underperformed relative to other market performances during an economic recovery.[145] Market observers noted as early as May that "markets continue to wobble from the scandalous collapse of Enron Corp., the widening circle of accounting irregularities and the treachery of Wall Street analysts."[146] By mid-summer, the market wobble had become a market rout.[147] As investor confidence plummeted, the nation's credit markets tightened just as the equity market crashed.[148]

There is now little doubt that the law can serve macroeconomic ends. A very straightforward example is the role of the law in structuring a central bank authority to oversee monetary policy in a way that is secured from the pernicious influence of special interests. Economists have thus recognized that an independent monetary authority is a fundamental part of macroeconomic infrastructure. I have previously posited that the law can help to secure other elements of a sound macroeconomic infrastructure — ranging from appropriate regulatory infrastructure to appropriate mechanisms to secure a more ideal means of investments in human infrastructure and physical infrastructure. Other scholars have identified other elements of a sound law and macroeconomics, without necessarily labeling it as such. I have similarly identified a number of common law principles that have macroeconomic consequences that should often trump other considerations, particularly the more limited concept of market efficiency.

These conclusions are certainly important, but they fail to light the way for the development of a unified theory of law and economics that can be useful to lawyers and judges in making common law, and to legislators and regulators in making and interpreting codified law.[149] It may be that such a theory of law and economics is not yet

145. *Supra* note 4.

146. Mark Davis, *Bear up, Again*, K.C. STAR, May 5, 2002, at G15.

147. By mid-summer, the signs of full fledged meltdown in investor confidence were manifest. Gary Strauss, *Scandal Further Decimates Investor Confidence*, USA TODAY, June 27, 2002, at D1.

148. Riva D. Atlas, *A Torrent of Loans Becomes a Trickle*, N.Y. TIMES, July 21, 2002, at Sec. 3, 1 ("For the last 17 months, banks have been cutting back on corporate lending, shunning companies in problem industries . . . and charging higher interest rates and bigger upfront fees on most other loans, even to top-rated companies in healthy industries."). One indication of the tightening in credit markets is the difference (or spread) between no risk Treasury bonds and corporate borrowing rates. The greater the spread, the tighter money is for corporate borrowers at a given zero-risk lending rate. By summer of 2002, those spreads were rapidly expanding.

149. This is not to say that law and macroeconomic considerations are not often quite clear; instead I merely am trying to highlight the difficulty with any comprehensive theory of law and macroeconomics, at present. In terms of clarity, macro considerations seem superior to efficiency analysis because efficiency analysis is often indeterminate and may even be futile in that it can be assumed that the law as presently constituted is the efficient market outcome. Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211, 1216 (1991) ("[T]he set of Pareto superior changes which would make no one worse off and at least one person better off must ex ante be a void set."); Duncan Kennedy, *Law-and-Economics From the Perspective of Critical Legal Studies*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 465, 470 (Peter Newman ed., 2000) ("[T]he Kaldor-Hicks solution will be radically indeterminate in the vast number of cases where there are two available efficient rules with different distributive consequences.").

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attainable, and that it may never be.[150] This article certainly does not purport to weave any such general theory. Instead, this article attempts to articulate and clarify the current state of the art of law and macroeconomics.[151] It therefore begins with the premise that not enough is known about how the law can support superior macroeconomic performance. Law and macroeconomics is in its infancy — the neglected half sister to the almost exclusive focus on efficiency that has thus far dominated the study of law and economics. This is an odd reality in that it seems beyond dispute that efficiency results in only a "trivial" influence (at best) on economic growth and other important macroeconomic measures.[152] Nevertheless, law and macroeconomics is only occasionally mentioned in the legal academic literature explicitly, and is only slightly more frequently the subject of studies that focus on macroeconomic impact, even if the word macro is nowhere to be found.

Recent events certainly lend credence to the idea that scholars and policymakers must be more mindful to the macroeconomic consequences of allowing free market efficiency dogma to dilute important regulatory infrastructure. Efficiency serves us best as a theoretical construct that demonstrates the power of free markets to allocate resources and to create incentives for profit maximization.[153] As such, all things being equal, the legal system should strive to create supports to facilitate market activity. There is little doubt that contract law, property law, and other important legal constructs should be driven by

150. To some extent it is understandable that there is only scanty scholarship on law and macroeconomics available. Economists have only recently started to study the determinants of macroeconomic growth, beyond traditional fiscal and monetary policy, which traditionally has been more focused on macroeconomic stability instead of growth. *Supra* note 54. Thus, the need for legal structures to implement the new teaching of macroeconomic growth theory has been somewhat limited. *See* GORDON, *supra* note 51, at 304-12 (discussing emergence of endogenous growth theory which posits that growth (or technical change) is not exogenous ("dropping from the sky") but is instead endogenous, in the sense that it can be intelligently studied and pursued).

151. The current state of law and macroeconomics is that we are dependent upon historical experience and macroeconomic theory itself to provide the answers to the bulk of our questions regarding how the law can serve macroeconomic performance. *Supra* notes 49, 84, 109. To a lesser extent we can depend upon careful macroeconomic empirical studies to light the way. *Supra* notes 54, 90, 95. Certainly, law and macroeconomics yields very clear results in certain areas, like investor confidence. *Supra* notes 43-45.

152. Kelman, *supra* note 35, at 1223.

153. Efficiency as used by most law and economics scholars has vague, indeterminate, and subjective meaning. It has definite meaning in the world of microeconomics, but only as a theoretical construct. *See* EDWIN MANSFIELD & GARY YOHE, MICROECONOMICS 565 (10th ed. 2000) (stating that "[o]ne of the most fundamental findings of microeconomics is that a perfectly competitive economy . . . satisfies the . . . conditions for economic efficiency"). This is because micro economists recognize that no economy is ever perfectly competitive. *Id.* at 270. Perfect competition rests upon theoretical assumptions that all recognize are never fulfilled — such as the requirement that all market participants possess perfect information of the past, present, and future. *Id.* Perfect competition also requires zero transaction costs so that assets can move via market action to their highest and best use unimpeded. *See id.* Thus, perfect competition militates in favor of *de minimus* government intervention because government action implies some transaction costs.

efficiency considerations, as a general matter.[154] Still, the law can do much more. Free markets are the minimum law can deliver, not the ideal that law can deliver.[155] The law must create an adequate and politically independent monetary authority, and this it has done, for the most part.[156] I have posited that there exists an optimized macroeconomic infrastructure that can lead to the greatest degree of macroeconomic stability and growth. This paper is a search for the right regulatory infrastructure to secure an optimized investor confidence, in the sense that risks are reduced to a minimum, and the cost of capital is lowered for both the capitalist and the entrepreneur. Fear of infidelity, fear of macroeconomic instability, fear of costly and frivolous litigation — all take a bite out of the ability of our free capital markets to allocate capital.[157] In addition, this higher cost of capital also results in less GDP, less investment, and less likelihood of productivity growth. With this in mind, the next section of this article seeks to test the regulatory infrastructure of the U.S. and suggest improvements to the regulatory infrastructure, particularly in light of the historic crisis of confidence that beset the U.S. in 2002.

II. THE LAW AND MACROECONOMICS OF INVESTOR CONFIDENCE

The law in the U.S. has strived to enhance investor confidence in order to support macroeconomic performance since at least the Great Depression. Deposit insurance encourages savers to part with their money without having to spend inordinate amounts of time and money (to purchase trustworthy expertise) searching for a safe depository institution and monitoring its business practices, or simply stuffing their excess cash under their mattress.[158] Securities regulation forces companies to accurately disclose material information so that

154. *E.g.*, RUDI DORNBUSCH, KEYS TO PROSPERITY: FREE MARKETS, SOUND MONEY, AND A BIT OF LUCK (2000) (arguing that allowing maximum operation of free markets is a key element to macroeconomic growth) [hereinafter DORNBUSCH II] .

155. Recently, for example, economists have highlighted the relative efficiency of the very critical labor markets of the 1930s. Theoretically, labor markets should have adjusted to the large unemployment at the beginning of the Depression by lowering wages and thereby inducing higher demand for workers. Some had previously argued that "sticky wages" were responsible for the lack of market adjustment. *See* Ben S. Bernanke & Kevin Carey, *Nominal Wage Stickiness and Aggregate Supply in the Great Depression*, 111 Q.J. ECON. 853, 855 (1996). "During the 1930s many forces that . . . economists commonly point to as conducive to slow wage adjustment appeared relatively weak in most countries: union power was at low ebb; government's role in labor markets was generally more limited than today; price declines were too large . . . for money illusion to be widespread; and the existence of an army of the unemployed must have . . . reduced workers' bargaining power." *Id.* Thus, it is clear that market efficiency, without macroeconomic infrastructure, is a condition consistent with severe depression.

156. Ramirez I, *supra* note 15, at 553-54 ("Congress has endowed the Fed with the power to move quickly and expertly in administering monetary policy — essentially free from the influence of special interests.").

157. *Supra* notes 51-67.

158. *See generally* Banking Act of 1933, ch. 89, § 8, 48 Stat. 162, 168 (codified as amended at 12 U.S.C. §§ 1811-1832 (2000)). The FSLIC, a savings and loan corollary to the FDIC, was formed in 1934. National Housing Act, ch. 847, 48 Stat. 1246 (1934).

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investors may assess the prospects of issuers and intelligently allocate money to more promising enterprises, without having to undertake negotiations for information with individual issuers and without having to spend time assessing which companies are willing to adequately disclose information.[159] The Federal Reserve stands ready to inject liquidity and lower the short term cost of capital, in order to short-circuit cyclical downturns, without having to contend with special interest (or inordinate political) influence.[160] All of these innovations are essential elements of a well-ordered scheme of social capitalism, and central to the maintenance of investor confidence; in essence government eliminates unnecessary risks from the capital formation process and thereby lowers the cost of capital to private market participants.[161]

But, much more needs to be done. Basically investor confidence breaks down into two elements: economic risks of loss and infidelity risks.[162] With respect to infidelity risks, law and regulation looms large. In the context of business regulation, I have previously argued that insulating corporate managers and securities professionals from liability for securities fraud is an illogical way of stemming frivolous lawsuits, which instead should be stemmed by an accelerated means of a merit-based adjudication.[163] Nevertheless, in a classic scene of corporate statism, special interests used political influence to secure beneficial legislation for the few at the expense of investor confidence, and therefore, society as a whole.[164] Specifically, in 1995 Congress enacted (over a Presidential veto) the Private Securities Litigation Reform Act (PSLRA)[165] that effectively insulated (and perhaps more importantly gave potential defendants the perception of insulation)

159. *See generally* Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a to 77z-3 (2000)); Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a to 78mm (2000)).

160. *See generally* Banking Act of 1935, ch. 614, 49 Stat. 684 (codified as amended at 12 U.S.C. § 241 (2000)).

161. This amounts to the creation of regulatory infrastructure under mainstream economic thought. *See* GORDON, *supra* note 51, at 331. Eliminating unnecessary risks is akin to providing an economic environment supported by political stability — certainly, it is beyond cavil that political risk is an unnecessary risk to capital formation and that government should limit this risk whenever possible. *See* Claire A. Hill, *How Investors React to Political Risk*, 8 DUKE J. COMP. & INT'L L. 283, 312-313 (1998). "[E]vidence suggest[s] that investors have difficulty with political risk assessment — that investors often alternate between assessments that, in hindsight, were either much too high or much too low." *Id.* at 286. So it is with the risk of default facing depositors, the risk of disclosure flaws facing securities investors, and the risk of major macroeconomic disruptions facing business generally.

162. *Supra* note 58.

163. Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing With the Meritorious as Well as the Frivolous*, 40 WM. & MARY L. REV. 1055, 1140 (1999) (arguing that wider arbitration of securities disputes would enhance investor confidence by providing a quick and effective remedy as well as deter frivolous lawsuits by providing for an accelerated merit-based adjudication of claims) [hereinafter Ramirez IV].

164. Ramirez I, *supra* note 15, at 560-62.

165. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.).

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securities fraudfeasors from liability under the federal securities laws in a myriad of important ways.[166] In 1998, Congress followed up this indefensible legislation, with the Securities Litigation Uniform Standards Act, which pre-empted state law claims in certain securities cases.[167] In the wake of this legislation, and for the first time since 1933 when the federal government began to regulate securities, federal law was used to *narrow* investor remedies.[168] All of this legislative activity was pursuant to lavish lobbying and contribution campaigns undertaken by accounting firms, business managers, and securities firms.[169] Sooner or later this regime of private securities litigation, one which was fundamentally stacked against investors, would hurt investor confidence and encourage further illicit conduct in our business sector.[170] With studies showing the median settlement amount for PSLRA class actions as low as 2.29 cents per dollar of damages, the deterrence effect of private securities litigation has been eviscerated. It is profitable to be a securities fraudfeasor.[171] This is why accountants are not accounting, directors are not directing, managers who manage their company into bankruptcy are getting rich,

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166. Ramirez IV, *supra* note 163, at 1072-93 (stating that the Private Securities Litigation Reform Act (PSLRA) is a "betrayal of several fundamental goals of the federal securities laws and expose[s] our financial system to risks that are not fully appreciated"). Indeed, despite the proliferation of misconduct in the securities industry in the late 1990s that has recently come to light, private actions brought in state courts since the enactment of the PSLRA have stagnated, at best, and recoveries have declined or barely budged. The average settlement for claims since the enactment of the PSLRA is as low as 2.29 cents on the dollar — hardly a disincentive for securities fraud and arguably an invitation to defraud investors. *See* Mukesh Bajaj et al., *Securities Class Action Settlements: An Empirical Approach* (Nov. 16, 2000), at 3, 9, 28, *available at* http://securities.stanford.edu/research/studies/20001116_SSRN_Bajaj.pdf.

167. *See* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified in scattered sections of 15 U.S.C.).

168. Ramirez IV, *supra* note 163, at 1083-84 ("[F]ederal law . . . now serves only to diminish the rights of investors . . . . A more reactionary cycle could hardly have been imagined by the promulgators of the federal securities laws in the early 1930s."). It now appears that the most stable time in American financial history prevailed from the late 1930s (the onset of the New Deal) through the mid-1990s (the onset of financial deregulation) when effective federal fraud remedies and mandatory disclosure prevailed. Ramirez IV, *supra* note 163, at 1066 n.35.

169. Ann Reilly Dowd, *Look Who's Cashing in on Congress*, MONEY, Dec. 1997, at 132 (listing the PSLRA as the top example of the relationship between laws, money, and lobbying, and noting that PSLRA was backed by a $29.6 million war chest).

170. Ramirez IV, *supra* note 163, at 1093 ("[T]he PSLRA merely rigs private securities claims so that defendants almost always win. . . . [and it is a] threat to the long term stability of our securities markets."). *See also* Douglas M. Branson, *Running the Gauntlet: A Description of the Arduous, and Now Often Fatal, Journey for Plaintiffs in Federal Securities Law Actions*, 65 U. CIN. L. REV. 3, 24 (1996) (stating that money from the accounting industry and high tech industries backed lobbying efforts behind the PSLRA).

171. *See* Bajaj et al., *supra* note 166, at 28. The most meaningful number for the initial impact of the PSLRA is probably a comparison of the number of filings in the year before the Act (1995) and the year after the Act (1996). Filings dropped from 191 to 119. *Id.* at 3. After 1996, any rebound in the frequency of litigation could well be attributed to a higher frequency of misconduct. *See* UNITED STATES GENERAL ACCOUNTING OFFICE, FINANCIAL STATEMENT RESTATEMENTS: TRENDS, MARKET IMPACTS, REGULATORY RESPONSES, AND REMAINING CHALLENGES 4 (2002) (stating that "restatements due to accounting irregularities" grew by 145% from January 1997 to June 2002).

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and lawyers seem to turn a blind eye to unlawful conduct.[172] In other words, it is critically important that not only companies, but associated professionals be held to account for securities fraud. The PSLRA specifically undercut the liability of such affiliated professionals.[173] Certainly, a depoliticized SEC, if given the power, could serve to lend expertise and to rationalize this critical regulatory infrastructure.[174]

Another example of corporate statism in financial regulation that has hurt investor confidence is the legal obligations owed by business managers. I have argued that because it is clear that corporate governance provisions are not impounded into investors' decisions to buy or sell stock, managers are relatively free to impose indulgent standards upon themselves. They have exploited this power in a variety of ways, through the exercise of influence over legislatures, creating a regulatory race to the bottom in the corporate charter market.[175] Certainly, other commentators have theorized that competing jurisdictions act to create a race to the top, and not to the bottom.[176] There are real problems with this theory. First, managers can now obliterate their duty of care; given that this must be central to the reasonable expectations of investors, this can only be considered a ploy by those in control to indulge themselves.[177] Second, managers now have the ability to harvest millions in compensation while their shareholders go bust.[178] So long as executives of bankrupt firms haul in millions while leaving their shareholders penniless,[179] reality suggests that we have allowed the blinding adoration of market efficiency to lead us into the

172. *Supra* notes 1-14. Chairman Greenspan specifically remarked upon the failure of "[l]awyers . . . [and] auditors . . . to detect and blow the whistle on those who breached the level of trust essential to well-functioning markets." Greenspan, *supra* note 44, at 5.

173. Ramirez IV, *supra* note 163, at 1078.

174. Ramirez I, *supra* note 15, at 585.

175. *Id.* at 570-74 ("It has been an amazing dynamic: managers have simultaneously redoubled their compensation while [at the same time] striving to constrict their legal duties to almost nothing.").

176. *See id.* at 571-72 (and authorities cited therein).

177. *E.g.*, DEL. CODE ANN. tit. 8, § 102 (b)(7) (2001) (permitting the elimination of duty of care liability). *See also* Marc I. Steinberg, *The Evisceration of the Duty of Care*, 42 SW. L.J. 919, 928 (1988) (commenting on § 102 (b)(7) and concluding that "[t]he evisceration of the duty of care is a drastic step in the corporate governance framework. Any further erosion makes a mockery of state law principles of fiduciary duty"). Professor Steinberg also recognized the politics behind the manager indulgent insulating statutes that proliferated in the late 1980s. *Id.* ("State statutes that decline to recognize legitimate shareholder expectations in order to accommodate locally situated managements of companies are short-sighted.").

178. Sometimes insiders structure their plundering in a way that does not even result in income recognition. For example, WorldCom CEO Bernard J. Ebbers was ousted from his position in April, 2002 — and as of August, he still owed WorldCom $400 million. Steven Rosenbush, et al., *Inside the Telecom Game*, BUS. WK., Aug. 5, 2002, at 34; *see also* Mark Gimein, *You Bought. They Sold.*, FORTUNE, Sept. 2, 2002, at 64, 66 (summarizing findings of a study of "America's Losingest Companies" that showed while shares plunged 75% insiders raked in $66 billion dollars in stock sales alone).

179. Enron senior executives sold over $1 billion worth of stock in the months before the collapse of its stock while many Enron employees and investors lost their life savings. *See* Kurt Eichenwald, *Enron's Collapse: Audacious Climb to Success Ended in a Dizzying Plunge*, N.Y. TIMES, Jan. 13, 2002, at 1.

corporate governance gutter.[180] The race to the bottom has resulted in lax standards for managerial conduct across the board, and it is time to enact some form of federal incorporation so that traditional notions of director and officer responsibility can be restored, at least for publicly traded corporations.[181] Only if one believes that standards in corporate America are not too lax, can one conclude that there is any race to the top. What is needed is a uniform corporate charter for publicly held companies. The goal should be a fair corporate governance structure in accordance with the reasonable expectations of investors. This would save investors the need to investigate and seek legal advice upon the meaning of corporate charter terms. A depoliticized SEC could probably be counted on to impose balanced corporate governance provisions upon publicly held companies, if empowered to do so.

For the most part these forays into corporate statism can be easily reversed and can be done so without imposing oppressive, untested, or radical new regulatory requirements on business. Repealing the PSLRA would only require returning to a system of securities fraud resolution that prevailed before 1995 and had endured for over sixty years.[182] Granting the SEC the power to regulate the contents of charters for publicly held companies could return the law of director liability to exactly where it stood before the *Smith v. Van Gorkhom* case, and where it essentially stood for decades before that.[183] Imposing professional responsibility requirements upon lawyers and accountants to supervise their partners would return our legal system to

180. *See* Ien Cheng, *Executives in Biggest US Collapses Made $3.3bn: Fortunes Amassed in Just Three Years at Expense of Shareholders and Staff*, FIN. TIMES, July 31, 2002, at 1 (summarizing findings of a study conducted by Financial Times into the fortunes amassed by corporate insiders of the 25 largest U.S. bankruptcies since early 2001; finding that insiders garnered a total of $3.3 billion from 1999 to 2001 while shareholders were wiped-out). The Financial Times survey certainly supports the view that corporate governance standards have transmogrified into schemes to permit "intolerable plundering of nearly bankrupt companies by senior executives as their businesses were going down the drain." *More Work for Regulators*, FIN. TIMES, July 31, 2002, at 12. Still, it understates the point. The study only includes bankrupt companies. Thus, it excludes Qwest which is not quite dead yet. Qwest's founder cashed out $1.9 billion starting in 1998, and President Joseph P. Nacchio sold $248 million in stock. Rosenbush et al., *supra* note 178, at 34.

181. *See* Joel Seligman, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947, 949 (1990) (discussing laxity as a result of diminished shareholder litigation, restrictions in shareholder suffrage, and decline of tender offers); James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1209-21 (1988) (discussing legislation enacted in forty states in the three years after *Smith v. Van Gorkom* that allowed the restriction of the duty of care).

182. *See* Ramirez IV, *supra* note 163, at 1085 (stating that for six decades the federal securities laws have been a success, and that therefore any structural change like the PSLRA should be supported by compelling evidence).

183. The gross negligence standard is probably too permissive; nevertheless, it is an accurate reflection of the state of director liability (for non-banking corporations) law over the past century. *See* Joseph W. Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1095 (1968) (stating that directors have only rarely been held liable for mere negligence).

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where it was before the 1990s, when most such professionals practiced in partnerships with joint and several liability.[184] These reforms would do much to quell investor fears of infidelity and would not in any way threaten the business system with excessive regulation.[185] Transparency, deterrence, and compensation for defrauded investors could be secured merely by returning to the enforcement regime that prevailed prior to the recent run of securities fraud.

By the summer of 2002, it was readily apparent that serious reforms were needed, and the political branches acted to reconstruct investor confidence. On this point, the Sarbanes-Oxley Act of 2002 can only be termed a disappointment.[186] At best, it is much ado about little, at least until administrative agencies act to give the law its advertised effect.[187] For example, the Act's much ballyhooed stiffening of criminal penalties will have very little impact unless the United States Sentencing Commission hands down stiffer sentencing guidelines, as Congress has empowered them to do — a power that the Commission had before the Act.[188] Similarly, the Act does virtually nothing to provide viable private rights of action to defrauded investors, and it does not roll back any provision of the PSLRA.[189] Certainly, securing more reliable and independent audits is a laudable goal, and the Act takes positive steps in that direction, such as limiting the non-audit activities that audit firms offer their clients[190] and creat-

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184. Traditionally, lawyers were not permitted to prospectively limit their liability to clients. *See, e.g.*, ANN. MODEL RULES OF PROF'L CONDUCT R. 1.8(h) cmt. (4th ed. 1999). Nevertheless, bar authorities have upheld the ability of lawyers to practice in limited liability entities and escape liability for the malpractice of their co-owners without any disclosure to clients. *Id.*

185. As the market stabilized in late summer of 2002, momentum for reforms aimed at bolstering investor confidence may decline. Chairman Greenspan addressed this point:

> Perhaps the recent breakdown of protective barriers resulted from a once-in-a-generation frenzy of speculation that is now over. With profitable opportunities for malfeasance markedly diminished, far fewer questionable practices are likely to be initiated in the immediate future . . . . But even if the worst is over, history cautions us that memories fade. Thus, it is incumbent upon us to apply the lessons of this recent period to inhibit any recurrence in the future.

Greenspan, *supra* note 44, at 5.

186. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered titles of U.S.C.).

187. *E.g., More Work for the Regulators*, *supra* note 180, at 12 (calling Sarbanes-Oxley Act "one of the biggest expansions of the role of the US government in regulating the free market").

188. *See* Sarbanes-Oxley Act § 905. *See also* Mary K. Ramirez, *Just in Crime: Guiding Economic Crime Reform,* 34 LOY. L. REV. (forthcoming 2003) (arguing that Sarbanes-Oxley is largely irrelevant, and real sentences are a function of guidelines and departures). Ironically, Congress just approved guidelines for stiffer penalties in economic crimes that went into effect in November of 2001. *Id.* Thus, the Sentencing Commission could well take the position that no further stiffening is needed. Professor Mary Ramirez suggests the Commission should restrict departures, which occur in nearly one-third of all economic crime cases. *Id.*

189. *Cf.* Sarbanes-Oxley Act § 804 (extending statute of limitations for securities fraud). Extending the statute of limitations for private actions would appear helpful, but if the underlying claim is still relatively weak, it is meaningless. I have long advocated that the PSLRA effectively makes state law claims the best avenue of relief for defrauded securities investors. *See* Steven A. Ramirez, *Caveat Plaintiff: Congress Has Defederalized Private Securities Litigation*, J. KAN. B. ASS'N, Nov. 1998, at 16.

190. *See* Sarbanes-Oxley Act § 201.

ing a new "Public Company Accounting Oversight Board."[191] Still, much depends upon the ability of the new Board to withstand the pressures of special interests, *over the long term,* and the Board has a weak structure in terms of its resistance to special interest influence, given the economic resources of the accounting industry.[192] In general, the Act depends upon administrative agencies to implement its intent within 180 (or more) days of the Act's passage — a time period that could turn a temporary high issue salience regulatory environment, into a low issue salience environment.[193] Low issue salience is a boon to special interest influence.[194] While it is still too early to call the Act a political fraud on the investing public, it is also too early to rule out such an assessment.[195] Still, because the Act does not provide for tough new criminal penalties, does not provide new accounting standards, and fundamentally depends on administrative agencies that have been underfunded and ineffective in the past, there is at least an element of "bait and switch" being perpetrated upon investor confidence.[196]

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191. *See* Sarbanes-Oxley Act § 101.

192. *See* Sarbanes-Oxley Act § 109. The self-funding nature of the Board gives it the ability to be free of the appropriations process, but as a self-regulatory agency subject to the oversight of the SEC, it is only as independent as the SEC, which appoints its governing Board, approves its budget, and has plenary authority over its rules. *See* Sarbanes-Oxley Act § 107. The SEC does not have an independent structure, and this is reflected in its history. *See* Ramirez I, *supra* note 15, at 532-34. More recently, the SEC has been subject to the exercise of political influence by the accounting industry; this according to former SEC Chair Arthur Levitt, who was in the arena fighting special interests. Jane Mayer, *The Accountants' War*, THE NEW YORKER, Apr. 22 & 29, 2002, at 64 ("They waged a war against us, a total war."). Levitt attempted to restrict the ability of auditors to consult for their clients and attempted to require that options compensation paid to executives be expensed against earnings. *Id.* at 66. The accounting industry, however, had paid $39 million to politicians since 1989. *Id.* Levitt found that "it's almost impossible to compete with the effect that money has on these congressmen." *Id.* at 64. After losing the battles and the war Levitt reflected with respect to the accounting wars that "if ever there was an example where money and lobbying damaged the public interest, this was clearly it." *Id.* Thus, some skepticism about the SEC's ability to contend with the political influence of those it regulates is justified. An additional source of potential special interest influence is the fact that two of the five Board members must be CPAs, and with only five year tenure, these members will not be immune from thinking about future job possibilities. *See* Sarbanes-Oxley Act § 101(e).

193. *See, e.g.,* Sarbanes-Oxley Act § 102 (requiring registration of all auditors of publicly held firms with the Public Company Accounting Oversight Board (PCAOB) within 180 days), § 303 (requiring SEC to issue rules prohibiting improper influence on conduct of audits within 270 days), § 307 (requiring SEC to establish minimum standards of professional responsibility for attorneys practicing before it within 180 days), § 905 (requiring U.S. Sentencing Commission to "consider" guideline adjustments within 180 days of the enactment).

194. *Supra* note 38.

195. Prominent financial commentators have recognized already the potential lack of political independence of the PCAOB. *See More Work for the Regulators*, *supra* note 180, at 12 (stating "securing the independence and integrity of [the PCAOB] should be the highest priority of the SEC" particularly in light of the fact that "two of the five SEC commissioners are former partners with audit firms" and SEC Chair Harvey Pitt "himself earned millions in fees from accountants while he was in private law practice").

196. Sophisticated business voices soon remarked on the long term funding problems facing the SEC and the likelihood that Sarbanes-Oxley was "too little, too late" to address this problem despite the impressive 66% increase in funding under the Act for the SEC. Michael Schroeder, *SEC Gets a Raise, but Will it be Enough?*, WALL ST. J., Aug. 12, 2002, at C1. In the absence of a self-funded securities regulator, special interests will be able to mobilize Congress to threaten the SEC with budget cuts. *Id.* at C3 ("In 2000, Republicans and Democrats threatened to slash

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Nowhere is this more evident than in the area of private remedies. In addition to failing to roll back the PSLRA, the Sarbanes-Oxley Act fails to provide investors with any new remedies. The Act does create a new shareholder fraud crime — but provides no private right of action.[197] Private actions do not require any government funding, and therefore, assure compliance and deterrence even when government — as is often the case in financial regulation — is unwilling to foot the bill for administrative enforcement.[198] Private enforcement gives investors incentives to ferret out wrongdoing that may well be concealed to regulatory authorities.[199] Private enforcement is immune to political influence.[200] Finally, nothing repairs harms to investors better than money in their pockets.[201] This is why virtually every securities law enforcement official attests to the necessity of private enforcement mechanisms.[202]

Other reforms that may impair the ability of business to use its concentrated economic power to influence the regulatory infrastructure underlying the capital formation process may be viewed as somewhat more radical in terms of our history, but are now supported by powerful evidence. I have argued that because in the normal course

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the SEC's budget unless Mr. Levitt backed down from his proposed rules to limit significantly consulting services that auditors could offer corporate clients.").

197. *See* Sarbanes-Oxley Act § 807.

198. *See* 1 LOSS & SELIGMAN, *supra* note 51, at 146-51 ("As a practical matter, parsimonious state budgets have meant understaffing of state securities law programs."); *see also* John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 378 ("Depending on the SEC to fill any void caused by a decrease in meritorious private litigation may be unrealistic in an era of government austerity.").

199. *See, e.g.*, Berner v. Lazzaro, 730 F.2d 1319, 1322 (9th Cir. 1984) ("The resources of the [SEC] are adequate to prosecute only the most flagrant abuses.").

200. Experience has taught that the funding of the SEC is, unfortunately, subject to political caprice. For example, during the 1980s, when regulation of all sorts was not in vogue, the SEC was chronically underfunded. It was not until the end of the decade, when the pervasive crime in our financial markets began to manifest itself, that Congress authorized appropriate funding. *See The Market Reform Act of 1989: Joint Hearings Before the Subcomm. on Sec. of the Sen. Comm. on Banking, Housing, and Urban Affairs*, 101st Cong. 11 (1989) (statement of Sen. Sasser) (noting approval of 18% increase in SEC funding after it was "underfunded throughout the 1980's at a time when volume and complexity in the markets has increased enormously").

201. *See* S. REP. NO. 104-98, at 37 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 715 (statement of Sens. Sarbanes, Bryan, and Boxer) (stating that investor "confidence is maintained because investors know they have effective remedies against persons who would defraud them").

202. The former SEC Chief of Enforcement has stated: "Given the continued growth in the size and complexity of our securities markets, and the absolute certainty that persons seeking to perpetrate financial fraud will always be among us, private actions will continue to be essential to the maintenance of investor protection." *Private Litigation Under the Federal Securities Laws, Hearings Before the Subcomm. on Secs. of the Sen. Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 113 (1993) (statement of William R. McLucas, Director, Division of Enforcement, SEC) (pointing out, as former Chairman of the SEC, that "private securities litigation plays an essential role in federal securities regulation" and that approximately 90% of securities cases were privately pursued in 1988); *see also* David S. Ruder, *The Development of Legal Doctrine Through Amicus Participation: The SEC Experience*, 1989 WIS. L. REV. 1167, 1168 (pointing out as former SEC Chair that "private securities litigation plays an essential role in federal securities regulation" and that approximately 90% of securities cases were privately pursued in 1988).

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of business the public only sporadically attends to issues of complex business and financial regulation, this area of law is plagued by low issue saliency.[203] There is now little dispute that particularly in the 1990s the business community was able to achieve special interest legislation that was detrimental to the macroeconomy.[204] The government should now move to create a depoliticized financial regulator, to expertly craft optimized financial regulatory infrastructure.[205] Issues of financial regulation only benefit from democratic scrutiny when there is a crisis.[206] The norm is for the financial regulatory arena to be dominated by the interests of those who seek to use other people's money to fund their business.[207]

This leads to an environment that encourages raids upon the regulatory infrastructure governing our business system by special interests, such as managers, accountants, lawyers, and securities firms. The PSLRA was openly denounced in the media as special interest legislation yet, the issue never achieved salience in the public's consciousness and never figured as an issue in any political campaign.[208] Twenty-nine million dollars were spent to "persuade" legislators not only to pass the Act but to do so over a Presidential veto.[209] The expansion of limited liability was similarly enacted by lawyers for the benefit of lawyers, with little public discourse on the issue of professional responsibility.[210] The same is true for the insulation of the managers of our largest business concerns.[211] Much of this special interest legislation enjoyed the support of the laissez-faire efficiency school of law and economics.[212] With all of this "deregulation" and laissez-faire "efficiency," it is no wonder that the law is perilously close to killing the golden goose that has been the American Economy since the onset of social capitalism in 1932.[213] All of this special interest legislation also created a promiscuous business culture that fell prey to "infectious greed."[214]

203. Ramirez I, *supra* note 15, at 591-93 (arguing that a depoliticized structure can quell special interest influence and that financial regulation is well-suited for depoliticized regulation).

204. *Supra* notes 162-81, 184.

205. Ramirez I, *supra* note 15, at 592 ("[R]ecent history in financial market regulation strongly suggests that [financial] agencies . . . must move towards the Fed in terms of political insulation.").

206. *Id.*

207. *Id.* at 591-92.

208. *Id.* at 560-62.

209. *Supra* note 169.

210. *Supra* note 184.

211. *Supra* note 177.

212. RICHARD POSNER, OVERCOMING LAW 96 (1995) ("Law and economics has also contributed significantly to the deregulation movement . . . .").

213. Ramirez II, *supra* note 25, (manuscript at 1-20) (showing breakdown of orthodox laissez-faire economics in the late 1920s and early 1930s).

214. Greenspan, *supra* note 44, at 5. This promiscuous environment was even influenced by the exercise of influence over the American Law Institute, which promulgated the very influential ALI Principles of Corporate Governance. Alex Elson & Michael L. Shakman, *The ALI*

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No doubt this culture of greed was driven, in part, by a feeling of being above the law and insulated from any legal attack. For example, former Enron CEO Ken Lay was a top donor to the Bush campaign, and he has yet to be indicted as this article goes to press.[215] The sway our business leaders held in Washington, and their ability generally to achieve special interest legislation, also must have created a heady sense of confidence that their conduct would generate little sanction from the legal system.[216] To iron out the remaining elements of these attitudes, there must be an immediate stiffening of sentences applicable to corporate crime.[217] Moreover, as scholars are now beginning to recognize, judges must be partially stripped of their ability to hand out indulgences to the demographically and culturally identical business leaders that appear before them. In other words, sentencing departures must be restricted in this area of criminal law enforcement.[218] Thus far, Washington seems determined to play the game of "bait and switch" with the investing public rather than enacting real increases in the criminal exposure of white collar criminals.[219] When the public and the business community see a parade of corporate criminals behind bars, investor confidence will be restored and deterrence will be achieved.[220]

In the meantime, all of this politicking and laissez-faire law making has left our system of corporate governance with diluted director and officer standards, adulterated professional standards governing lawyers and accountants, and compensation payments to managers that have soared based upon a culture of artificially inflated earnings.[221] Despite the theoretical elegance of efficient free markets, the practical reality is that unregulated or under-regulated financial markets will lead passive investors to stash their cash under the mattress and avoid the securities markets like the plague.[222] This hurts

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Principles of Corporate Governance: A Tainted Process and a Flawed Product, 49 BUS. LAW. 1761, 1763-68 (1994).

215. *See* Jerry Zremski, *For Adelphia, A Rush to Prosecution*, BUFF. NEWS, Aug. 4, 2002, at A1 (stating that Enron and its employees contributed $2.8 million to political campaigns since 1999, including the Bush campaign, while Adelphia and its employees contributed only $215,575; Adelphia senior management has been indicted, and Enron's has not). On August 20, 2002, the government announced that an Enron secondary manager would be entering a guilty plea, so the Enron inquiry is still very much alive. Kurt Eichenwald, *Enron Official Is Reported Set to Plead Guilty*, N.Y. TIMES, Aug. 21, 2002, at A1.

216. *Supra* notes 162-81.

217. "[E]ven a small increase in the likelihood of large, possibly criminal penalties for egregious behavior of CEOs can have profoundly important effects on all aspects of corporate governance because the fulcrum of governance is the [CEO]." Greenspan, *supra* note 44, at 6.

218. *Supra* note 188.

219. *Id.*

220. *Supra* note 28.

221. Greenspan, *supra* note 44, at 5 (noting that options created a perverse incentive for insiders to "harvest" stock market gains by inflating earnings to increase the value of options).

222. DORNBUSCH II, *supra* note 154, at 131 (stating that a "well-supervised financial system" can serve to avoid a capital market crisis and that the Asian Crisis of 1997 was caused in part by "negligent or deliberate lack of regulation, supervision, and transparency"); Coffee, *supra* note

macroeconomic growth.[223] If there is any benefit to all of this deregulation of our financial markets and dilution of corporate governance standards, it is that it proves in compelling fashion that a depoliticized regulatory agency is desperately needed in this area. I have previously argued in favor of depoliticizing the SEC by making it a self-funded agency with tenure for commissioners.[224] I have also argued in favor of federal incorporation for publicly held firms, so that the SEC could expertly promulgate a uniform system of corporate governance that would act as a form contract between firms and shareholders that access U.S. securities markets.[225] This could save our corporate system from such manager indulgent provisions such as title 8, section 102(b)(7) of the Delaware Code, which permits directors to eliminate their duty of care.[226] Only a depoliticized regulator with broad power over the rights of investors could ever achieve the kind of durable regulatory infrastructure needed for maximizing output and macroeconomic growth. Without depoliticization, we now know from recent history that special interests will launch successful raids on regulation and turn it to their own ends, as soon as issues related to financial regulation fade from the public's radar screen. The SEC's unsuccessful efforts to resist the PSLRA, its failed efforts to force auditors to refrain from consulting for their audit clients, and its attempt to force expensing of options compensation all attest to the problems of politicized securities regulation.[227] Each of these failed efforts played a factor in the summer 2002 crisis of confidence.

There are other shortcomings in our system of financial fear management. One bulwark of investor confidence, which can serve to mitigate panics, is government macroeconomic management of monetary and fiscal policy. Monetary and fiscal policy management reduces the economic risks of investing. Monetary policy in the U.S. seems optimized, with minor exceptions. Political influence rarely exercises a pernicious role in formulating monetary policy, and there is no evidence that special interests have ever been able to subvert policy to

35, at 68 ("The more that stock markets are perceived to be an engine of economic growth, the more that the protection of investor confidence to prevent . . . disintermediation merits a priority as a public policy goal."). Professor Coffee relies extensively upon the empirical work by economists showing that common law countries with substantial protections for minority shareholders outperform less protective civil law regimes. *See* Rafael La Porta et al., *Law and Finance*, 106 J. Pol. Econ. 1113 (1998); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. Fin. 1131 (1997).

223. "In my judgment . . . unless the laws governing how markets and corporations function are perceived as fair, our economic system cannot achieve its full potential." Greenspan, *supra* note 44, at 6.

224. Ramirez I, *supra* note 15, at 585-91 (stating that SEC posed a "classic" context for depoliticization and highlighting how this can be achieved).

225. *Id.* at 570-74 (stating that consolidating regulatory power over publicly held firms can be "expected to pay dividends" in terms of honest and fair securities markets).

226. *Supra* note 177.

227. *Supra* notes 192, 222.

serve the needs of narrow corporate interests.[228] Monetary policy has been able to function in the U.S. with a high degree of flexibility and effectiveness, under the exclusive control of a highly expert management.[229] As such, monetary policy has been effectively deployed to avert macroeconomic catastrophes. In 1987, monetary policy was used to cushion the blow of a major stock market break.[230] After September 11, 2001, the effective use of monetary policy cushioned the blow of the dastardly terrorist attack on the World Trade Center in New York City and averted a financial panic driven by fear of our economic vulnerability to terrorism.[231] Aside from these major economic events, monetary policy has been used to avert adverse macroeconomic effects of a wide variety of exogenous events that could have stirred the kind of economic panic, driven by unfettered fear, that was a common affliction prior to the creation of the Fed in 1913.[232] Indeed, it is no exaggeration to say that the Fed has rescued capitalism and our society from many of the most unpleasant realities of unregulated capitalism.

One unpleasantness that monetary policy failed to forestall was the Great Stock Market Bubble of the late 1990s.[233] In hindsight, it appears clear that the Fed could have done more.[234] Specifically, some commentators believe the Fed should have used its power to adjust margin rates, as a means of deflating the bubble before its violent bursting.[235] The Fed is not chartered to control asset bubbles; its primary statutory missions are essentially to control inflation and maintain employment.[236] Consequently, any effort to stem the bubble could have easily exposed it to political pressure on a point where it

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228. Ramirez I, *supra* note 15, at 553 ("The historical and empirical record suggests that the Fed has not exercised its power over monetary policy for the benefit of special interests.").

229. *Id.* at 550-54.

230. *Supra* note 73.

231. *Supra* note 17.

232. Ramirez I, *supra* note 15, at 531 (stating that "severe economic contractions" occurred in six instances in the forty years prior to the creation of the Fed).

233. SHILLER, *supra* note 122, at 6 (terming the boom of the 1990s the "millennium boom").

234. A particularly interesting account, which relies upon many Fed internal documents, holds that the Fed knowingly refrained from restraining the developing stock market bubble. Alan Abelson, *Irrational Adulation*, BARRON'S, July 22, 2002, at 5-6.

235. 15 U.S.C. § 78g (2000) ("For the purpose of preventing the excessive use of credit for the purchase . . . of securities, the [Fed] . . . shall prescribe rules and regulations with respect to the amount of credit that that may be . . . extended . . . on any security."). This does not appear to give the Fed the power to manage margin rates to avert a bubble, but instead seems to empower the Fed to control margin debt in accordance with its overall monetary policies.

236. *See* 12 U.S.C. § 225a (2000) (stating that the goals of the Fed are enumerated to include "maximum employment, stable prices, and moderate long-term interest rates"). Bursting a bubble, necessarily means swimming upstream against popular opinion. The explicit power to manage overall macroeconomic performance and stability would seem to be sufficient to empower the Fed to burst asset bubbles before they threaten overall macroeconomic stability. I would propose this statutory addition to the goals of the Fed: "and to address any other risks to macroeconomic stability or growth, including, but not limited to, discouraging incipient asset bubbles."

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had little formalized wherewithal.[237] The very nature of a bubble means that a monetary authority resisting its expansion would be swimming against public opinion. Perhaps now, in the whirlwind of the burst bubble, political circumstances are right to give the Fed the explicit power to deflate bubbles; however, for the Fed to have appropriated that power without explicit legislative authorization would have been flirting with disaster. Its depoliticized structure does not mean that it can be absolutely immune from such political considerations.[238] Certainly, expanding the Fed's authority to manage investor psychology to avert future bubbles now seems appropriate.

Fiscal policy has been more problematic. It has been deployed to mitigate economic trauma and to smooth macroeconomic business cycles. In the Great Depression and World War II, an expansionary fiscal policy seemed largely responsible for reversing the Great Depression.[239] By the 1970s, at just about the time President Richard Nixon declared: "we are all Keynesians now," fiscal policy seemed to lose its stimulatory capacity as the economy stagnated even in the face of large federal budget deficits.[240] It was as if there was a law of Conservation of Fiscal Stimulus, holding that although fiscal stimulus is possible in the short term, it creates future drags on the economy in the form of debt and interest burdens upon the economy.[241] Unless government spending yields productivity gains (like the Interstate Highway System) that exceed the cost of capital, fiscal stimulus ex-

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237. Ramirez I, *supra* note 15, at 550 (stating that Fed must "guard jealously" its political independence by playing politics).

238. *Id.* at 550, n.286 (quoting Rudi Dornbusch, *Growth Forever*, WALL ST. J., July 30, 1998, at A18). "The Fed is a keenly political institution simply because that is the only way it can maintain the independence necessary to make good policy." *Id.*

239. GORDON, *supra* note 51, at 583-84.

240. President Nixon's statement coincided more with the realization that Keynesian fiscal policy was more complicated than previously thought, rather than the absolute rejection of fiscal policy. As Professor Krugman has highlighted:

> When it comes to the U.S. economy, everyone — including people who imagine that they have rejected Keynesianism in favor of some doctrine more congenial to the free-market faithful — in practice views the current slowdown in terms of the intellectual framework John Maynard Keynes created 65 years ago. In particular, everyone thinks that during a slump what we need is more spending.

Paul Krugman, *Other People's Money*, N.Y. TIMES, July 18, 2001, at A23. For example, economists have recognized that the Bush administration in particular has frequently invoked Keynesian economics in favor of its economic policies. Brian Peterson, *Statement of Assistant Professor of Economics at Manchester College*, *at* http://www.manchester.edu/connect/pr/files/news/pr_peteroped.htm (last visited Aug. 21, 2002). Even critics of Keynesianism recognize the validity of its central teaching: in certain circumstances fiscal stimulus can revive an economy. *See* Steve H. Hanke, *We Were All Keynesians — Then* (Feb. 22, 1999), *at* http://www.forbes.com/global/1999/0222/0204077a.html (last visited Aug. 21, 2002). All of this is consistent with the concept of a disciplined and intelligent fiscal policy function, even if the idea that prosperity is as easy as endless government deficits has died. Such unrestrained fiscal stimulus was never advocated by Lord Keynes. He specifically did not address a scenario where promiscuous fiscal policy damaged investor confidence so much as to cancel out any stimulus gains, as his critics recognized as a possibility some six decades after his seminal work. *Id.*

241. DORNBUSCH ET AL., *supra* note 34, at 442-43 (stating that to the extent the debt is foreign held, interest payments on deficits create a future tax burden).

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pires and leaves in its wake a contractionary debt burden on the economy.[242] Thus, there is no net long term gain from even temporary fiscal stimulus absent productivity gains. Endless deficits, like those in late 1960s and 1970s, are bound to come home to roost in the form of higher real interest rates and enhanced inflationary expectations, which burden the capital formation process and destroy the ability of deficits to stimulate growth.[243]

Fiscal policy as a means of protecting the economy from fear, panic, and low business expectations has been hopelessly compromised. First, fiscal policy has been deployed chaotically and with little macroeconomic responsibility.[244] Instead, it seems that fiscal policy only coincidently serves any cognizable macroeconomic policy goal, at worst, and only occasionally furthers any macroeconomic goals, at best.[245] Second, the spending pursued by the government is far more focused on serving immediate political needs, rather than enhancing productivity.[246] Perhaps, this is inevitable in a democracy, but the experience of the Fed counsels otherwise.[247] In creating the modern Fed, Congress endowed it with the power to print money.[248] Yet, at the turn of the century, the rigidity of the money supply was a major political issue.[249] Thus, moving the issue of the money supply away from the democratic branches was a major step in the construction of our nation's macroeconomic infrastructure.[250]

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242. *See id.* at 333 ("A low-tax — high-government spending policy that produces large deficits raises the real interest rate and discourages the demand for capital."). The idea that there may be a Law of Conservation of Fiscal Stimulus may only be a restatement of the fundamental economic law that you can't get something for nothing. *See also* GORDON, *supra* note 51, at 355 ("If the federal government creates debt to build a beneficial long-lasting project, then the return on the project is available to cover the interest payments to foreigners. If the debt is created to pay for current consumption, there is no future return to balance the extra taxes needed to pay the interest to foreigners.").

243. BYRNS & STONE, *supra* note 37, at 128-30 (showing that uninterrupted deficits from 1970 to the mid-1990s were associated with serial recessions, high inflation, and low productivity growth).

244. From 1970 to the third quarter of 1997, the U.S. government ran a budget deficit for 111 straight quarters. GORDON, *supra* note 51, at A5-A7. This is hardly the Keynesian Fiscal Policy that seeks to use government deficits to address inadequate aggregate demand. BYRNS & STONE, *supra* note 37, at G-12. Economists have expended much effort to explain persistent deficit bias. *See* DAVID ROMER, ADVANCED MACROECONOMICS 547-72 (2d ed. 2001) (concluding that divided governments with divided control over the budget (e.g., a Democratic Congress and a Republican President) are most prone to deficits). The parallel to monetary policy is patent. Just as politicians are always tempted to print money to curry short term favor with voters, so they are tempted to spend more and tax less.

245. ROMER, *supra* note 244.

246. One commentator has focused, appropriately, on the role of the law in structuring and organizing such investments in a way that assures that the political process does not operate to deprive such investments of their associated productivity enhancements. W. Mark Crain & Lisa K. Oakley, *The Politics of Infrastructure*, 38 J.L. & ECON. 1, 15 (1995) ("[T]he marginal productivity of public capital across political jurisdictions and over time depends in part on the interplay between the existing institutional arrangements and the strategic use of infrastructure.").

247. *Supra* note 156.

248. Ramirez I, *supra* note 15, at 523.

249. *Id.* at 531.

250. *Supra* notes 229-38.

What is needed is a similar step for the creation of a depoliticized means of managing government investment in a rationalized manner. Such an authority could use government investment in a countercyclical fashion.[251] This would minimize the crowding out effect of government spending because the investment part of government spending would be managed to coincide with economic downturns.[252] A depoliticized authority could be expected to manage fiscal policy responsibly and with discipline, just as the Fed manages monetary policy.[253] Expert administration could channel investment funds to the highest and best yielding projects, and in the regions where investment capital is most scarce.[254] The focus on the selection of projects would be more on productivity enhancement, rather than on political patronage.[255] Essentially, this would formalize and institutionalize a disciplined and productive government investment function to replace the ad hoc and politically driven investment function now in operation.[256]

The idea of a public investment function is not new. Adam Smith recognized the need for government investment in order to assure that an economy operates at its maximum potential.[257] His insight that some investments will produce more benefits than costs, yet elude capture by any investor or investor group, holds true today as it did in 1776.[258] Herbert Hoover recognized the need for a countercyclical investment function to stem economic downturns as early as the

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251. This is the original and still widely accepted conception of Keynesian Economics. *Supra* note 244.

252. *Supra* note 100.

253. *Supra* note 156.

254. *Id.*

255. *Supra* note 246.

256. *Supra* note 244.

257. SMITH, *supra* note 98, at 473 (government is duty bound to provide "public institutions" and "public works" which may be "in the highest degree advantageous to a great society" but which are not profitable to any individual economic actor because of diffusion of benefits).

258. A classic example is the G.I. Bill, signed into law by President Roosevelt in 1944. Servicemen's Readjustment Act of 1944, ch. 268, 58 Stat. 284, 291 (codified as amended at 38 U.S.C. §§ 1801-33). "The GI Bill of Rights was the law that worked, that law that paid for itself and reaped dividends because it made the American dream come true." MICHAEL J. BENNETT, WHEN DREAMS CAME TRUE: THE GI BILL AND THE MAKING OF MODERN AMERICA 317 (1996). This is consistent with a variety of studies showing that government expenditures on education do not cost — they pay. *See* GEORGES VERNEZ ET AL., CLOSING THE EDUCATION GAP: BENEFITS AND COSTS (1999) (undertaking detailed study of costs and benefits of education spending and finding that "closing the education gap for blacks and Hispanics would clearly pay for itself not only through the resulting long term savings in income transfer and social programs, but also through the resulting increased tax revenues and disposable income of the individuals involved"); Edward P. St. John & Charles L. Masten, *Return on the Federal Investment in Student Financial Aid: An Assessment for the High School Class of 1972*, 20 J. STUD. FIN. AID. 4, 19 (1990) ("[W]e conclude that the net present value of each dollar invested in student aid during the 1970s was about $4.30."). Even these analyses may be stilted. Economists have identified educational investments as a key element of macroeconomic growth. *E.g.,* Paul M. Romer, *Increasing Returns and Long-Run Growth*, 94 J. POL. ECON. 1002 (1986). The point is that education investments will not be undertaken by private actors because the benefits are diffused throughout the economy, and no single economic actor can capture a sufficient amount of such expenditures to justify the initial investment.

1920s.[259] John Maynard Keynes argued in favor of a "socialized" investment function in his seminal work, *The General Theory of Employment, Interest, and Money.*[260] The basic concept is therefore well within the mainstream of traditional capitalistic thinking. Indeed, an example of the fundamental power of well-considered government investment is the role the U.S. government played in the construction of the Internet.[261]

More and more evidence suggests that such a function would give the government more effective tools to manage investor confidence, stem fear and panic, and spur macroeconomic growth. First, the fact that monetary policy alone cannot manage every crisis in business confidence means that fiscal stimulus cannot be left to chance.[262] In fact, the experience in Japan suggests that if stimulus is not applied in a timely fashion, even dual monetary and fiscal expansion can fail to revive moribund investor confidence.[263] Second, recent macroeconomic evidence shows that an interventionist government that rationalizes its investment function — especially with respect to education[264] — enjoys better growth prospects over the long term.[265] Third, as expectations of greater stability and growth become impounded into investor psychology, the economy will benefit from lower capital costs.[266] From a doctrinal perspective, a rationalized public investment function is critical to macroeconomic prospects. Just as the Fed was created to be a lender of last resort, it is time to create an investor of last resort.

Certainly, the details of a depoliticized federal investment board are beyond the scope of this general article addressing the need to secure investor confidence by all means necessary. Still, the concept is much closer to reality than may be initially assumed. As recently as 1986, the President of the U.S. advocated an amendment to the Constitution that would have required a balanced budget.[267] In 1985,

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259. WILLIAM J. BARBER, FROM NEW ERA TO NEW DEAL: HERBERT HOOVER, THE ECONOMISTS AND AMERICAN ECONOMIC POLICY, 1921-1933, at 15-22 (1985).

260. KEYNES, *supra* note 40, at 378 ("I conceive, therefore, that a somewhat comprehensive socialisation of investment will prove the only means of securing . . . full employment."). In the context of his discussion it is clear that Keynes meant a government supplemented investment function as opposed to a governmental displacement of private investment.

261. A Brief History of the Internet, written by many of the innovators responsible for its technical attributes, is available at http://www.isoc.org/internet/history/brief.shtml. This history openly acknowledges the role of government investment.

262. *Supra* notes 96-119.

263. *Supra* note 118.

264. *Supra* notes 246, 258.

265. *See* Joseph E. Stiglitz, *Some Lessons From the East Asian Miracle*, 11 WORLD BANK RES. OBS. 151 (1996) (showing that economic growth is frequently accompanied by government intervention designed to create environments in which markets can thrive). Macroeconomics is not just about fiscal or monetary policy anymore.

266. *Supra* note 61.

267. *See* Kate Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 CAL. L. REV. 595, 597 n.18 (1988).

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Congress legislated that the budget deficit be eliminated by 1991.[268] Thus, it is conceivable that the political branches may find a way to impose fiscal discipline over the federal budget.[269] I simply propose an even more economically rational way to discipline federal fiscal policy: a requirement that all *current* expenditures by the government be pursuant to a balanced budget and all *investment* outlays be ceded to the control of a depoliticized federal agency. Unfortunately, history suggests that this kind of reform, which would effectively strip Congress of direct control of billions of dollars of budget outlays, has little hope of ever being a reality, short of a macroeconomic disaster.[270]

These deficiencies in our regulatory infrastructure are critically important to our society, and there is little time to waste. This article has shown how macroeconomically important the maintenance of investor confidence is. Our infrastructure should minimize the power of fear to impair capital formation and thereby maximize output and growth. An optimized regulatory infrastructure would quell fear, inspire investor confidence, and lower the cost of capital. Additionally, in an era where the U.S. has propagated an integrated economic and financial system, across borders, it is critically important that we show the world how well social capitalism can function. To the extent we fail, the U.S. will face costs in terms of foreign policy failures. Globalization also poses the risk that competing economies, such as the European Union, will implement superior systems of regulatory infrastructure. This would expose our population to a chronic competitive disadvantage in terms of capital flows. Such a disadvantage would coincide with a brewing demographic catastrophe: the retirement of the baby boom.[271] Indeed, a recent study suggests that poverty may well soar as the baby boom retires in greater numbers.[272] There is little doubt that the American economy can grow out of these woes; however, this is unlikely to occur if indulgent corporate statism continues to impede our ability to achieve an optimized regulatory

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268. *Id.* at 596.

269. Indeed, the Clinton administration presided over a virtually unprecedented run of budget surpluses. *See Final Clinton Administration Report on Budget, Economy: Before the Senate Comm. on the Budget*, 106th Cong. (2001) (statement of Jacob J. Lew, Director, Office of Management and Budget).

270. "The Depression offers little hope that a change in policy regime can be quickly effected when conditions change. It required a long wait and a long economic decline before a new regime could . . . be implemented." TEMIN, *supra* note 41, at 132.

271. *See generally* Christine Dugas, *Retirement Crisis Looms as Many Come up Short*, USA TODAY, July 19, 2002, at A1 ("Crippling stock market losses and shortcomings in the U.S. pension system are creating a retirement crisis . . . .").

272. *Id.* ("More than one-third of adults say they have no money saved in any kind of retirement account . . . .").

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infrastructure to support investor confidence and quell corrosive fear in the capital formation process.[273]

Perhaps the best reason for improving our regulatory infrastructure insofar as investor confidence is concerned is our ignorance. We live in a very complex world economy.[274] Even the best and the brightest among us recognize how dangerous and incomprehensible its evolution has become.[275] If history is any guide, then today's orthodoxy is likely to give rise to tomorrow's economic calamity.[276] In the past few years, our brushes with one potential meltdown after another are reason for policy makers to be anxious.[277] At the very least, the legal system should strive to give our economic policymakers the firmest possible legal foundations for our macroeconomy, and the most broad array of policy tools we can imagine, within the bounds of our Constitution.[278]

III. CONCLUSION

Government is unavoidably responsible for facilitating the operation of free markets by securing investor confidence. A comprehensive scheme of legal support for securing investor confidence, and minimizing the threat fear poses to a modern economy, includes mechanisms for regulating the integrity of financial markets, mechanisms for the regulation of monetary policy to stabilize

273. *Thumped: But Don't Write Off American Capitalism Just Yet*, THE ECONOMIST, July 13-19, 2002, at 11 ("[T]he scandals do show that repairs are needed if the most creative, enterprising and productive system ever devised is to realise its full potential.").

274. Alan Greenspan, *Understanding Today's International Financial System* (May 7, 1998), *at* http://www.federalreserve.Gov/boarddocs/speeches/1998/19980507.htm (stating that increased understanding is needed to stem "a systemic disruption" beyond comprehension).

275. *Id.* Given Greenspan's role as Chief Economic Firefighter, *supra* notes 17, 73, it is particularly disconcerting that even he appears to be at a loss to explain the inherent instability of the global economic system.

276. TEMIN, *supra* note 41, at 87 ("The Great Depression bears eloquent witness to the dangers of clinging to economic policies long after their utility has been replaced by growing danger."). Indeed, today's orthodoxy, at least within the legal academy, is that law and economics demonstrates that regulation should only follow compelling proof of a market failure. *See, e.g.*, Langevoort, *supra* note 36, at 68 ("[W]e could be rescued from all this [evidence supporting regulation] by a turn in the finance research back toward efficiency . . . . But we shouldn't commit to that account simply because it offers more comforting solutions or is politically more palatable."). This heavy bias towards deregulation almost came home to roost in the summer of 2002, when deregulation allowed corporate managers and the financial services industry to pursue their own interests unencumbered by private litigation or serious financial regulation (i.e., a regulatory scheme that is well-funded and depoliticized) at the expense of investor confidence.

277. Many economists felt that the world economic system faced a huge shock in 1982, when both Britain and the U.S. simultaneously pursued deflationary policies in the face of economic downturns. TEMIN, *supra* note 41, at 40 (quoting Boston Federal Reserve Bank president, Frank Morris). I have already catalogued the crises and near misses that have plagued the world economy since 1982. *Supra* notes 1-14, 17, 73.

278. I have previously shown the constitutional limitations to the creation of independent administrative agencies. Ramirez I, *supra* note 15, at 513-16. A comprehensive legal infrastructure to facilitate economic growth would include much more than the elements of a regulatory infrastructure to support investor confidence. It would also extend to legal structures to support appropriate human, social, and physical infrastructure. Economists term all of this social infrastructure. *See* ROMER, *supra* note 244, at 143.

macroeconomic performance, and mechanisms for regulating government expenditures to stabilize and enhance macroeconomic performance. This paper has attempted to show that political influence has stilted adequate financial regulation and that the financial regulatory structure that does exist has been unjustifiably skewed towards serving the short term needs of special interests. Additionally, this paper has shown that government spending too has been powerfully skewed towards corporate statism and away from social capitalism in that there are virtually no legal structures in place to assure that government expenditures are macroeconomically optimized.

Unfortunately, the American system of social capitalism appears only to progress away from the hazards of laissez-faire (which is still a rhetorically and politically powerful ideal in America) and the excesses of narrow corporate statism when a serious crisis sets in. There is, however, reason to believe that this may change. First, because the U.S. economy is more internationally wired than ever, our shortcomings in securing investor confidence are likely to be more easily revealed and to have more severe adverse consequences. Second, other economies throughout the world are likely to learn from American folly and to challenge American standards in a more meaningful way than in the past. This is already occurring with respect to accounting standards and is likely to provoke more introspection in the U.S. on what approach works the best. Third, the entire concept of law and macroeconomics has only recently started to command the attention of both legal and economic scholars in a way that is likely to produce more thinking about the importance of investor confidence and the economically optimal ways that the law can secure investor confidence. Hopefully, this paper is a step in the right direction.

There are other more general lessons to learn from our nation's history with respect to the legal management of investor confidence. First, is the mysterious absence of any real discussion of investor confidence in the current law and economics literature. I posit that more than anything this reflects a systematic political bias against any kind of government intervention, even under the most compelling economic circumstances. Second, it is clear that only fear and its corrosive macroeconomic effects have given rise to the role of government in creating macroeconomic regulatory infrastructure to manage investor confidence. I posit that this is a result of a continued need to indulge free market dogma and that in the long term, as government action stabilizes the macroeconomy to an ever increasing extent, this indulgence could prevent our society from ever settling into a macroeconomically optimized role for government. Instead, our adoration of laissez-faire rhetoric (both within and without the world of

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legal scholarship) is likely to cause stagnation instead of optimization. Finally, it is likely that to the extent the U.S. fails to optimize its legal structures to enhance macroeconomic growth, the economies of Europe, the Far East, or elsewhere, will.

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