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AGAINST REGULATORY STIMULUS

ERIK F. GERDING*

I

INTRODUCTION

The 2012 JOBS Act¹ deserves close scrutiny not only because of its impact on federal securities laws, but because it represented an attempt by Congress to use deregulation as a macroeconomic tool to jumpstart growth. When enacted in 2012, the U.S. economy was still struggling to recover from the global financial crisis. After the crisis, traditional macroeconomic tools were either rendered ineffective or appeared politically infeasible. Interest rates were already close to zero, and fears grew that global economies had entered a “liquidity trap.”² Meanwhile, the Republican-controlled House of Representatives consistently blocked Democrats’ fiscal spending initiatives. With traditional monetary and fiscal channels blocked, Congress enacted the JOBS Act, which offered a third potential way to stimulate the economy: deregulation of the financial sector. The text,³ legislative history,⁴ and media reports⁵ of the JOBS Act all include descriptions of the legislation as attempting an alternative form of macroeconomic stimulus.

This framing should not be casually dismissed as an anomaly, notwithstanding the fact that many members of Congress may have seized on economic conditions

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1. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified in scattered sections of 15 U.S.C.).

2. For one academic view at the time, see Paul Krugman, *How Much of The World Is in a Liquidity Trap?*, N.Y. TIMES (Mar. 17, 2010, 8:48 AM), <https://krugman.blogs.nytimes.com/2010/03/17/how-much-of-the-world-is-in-a-liquidity-trap/?auth=login-smartlock> [<https://perma.cc/6UZK-EKA4>]. A liquidity trap describes a market phenomenon in which extremely low interest rates make holding bonds unattractive, prompting investors to hold cash. See generally Gauti H. Eggertsson, *Liquidity Trap*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS (2008).

3. The statute’s preamble explained that the legislative intent was “[t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.” Jumpstart Our Business Startups Act preamble, 126 Stat. at 306.

4. H.R. REP. NO. 112-406, at 1 (2012).

5. Alexandra Alper, *Obama Signs Bill to Boost Business Startups*, REUTERS (Apr. 5, 2012, 3:58 PM), <https://www.reuters.com/article/us-usa-jobsact/obama-signs-bill-to-boost-business-startups-idUSBRE83414F20120405> [<https://perma.cc/F7YL-AE4Y>]; Michael Lewis, *What Is the JOBS Act (Jumpstart Our Business Startups)*, MONEYCRASHERS, <https://www.moneycrashers.com/jobs-act-business-startups/> [<https://perma.cc/3NFU-8V36>]; Amy M. Wilkinson, *JOBS Act a Win for Startups and Economy*, CNN (Apr. 10, 2012, 6:15 AM), <https://www.cnn.com/2012/04/09/opinion/wilkinson-jobs-act/index.html> [<https://perma.cc/65Y9-925S>].

as pretext for long-sought deregulation of capital formation or the fact that the “Great Recession” officially ended in June 2009.⁶ Indeed, the JOBS Act may serve as precedent. With the United States and other countries experiencing persistent low interest rates, rising national debt levels, polarized electorates, and political climates favoring austerity, policymakers may be tempted to see the JOBS Act as precedent and respond to the next recession or even the next financial crisis with financial deregulation.⁷ Policymakers would have scholarly support; Yair Listokin, for example, advocates using non-financial deregulation as “expansionary legal policy” to help economies escape a liquidity trap when interest rates approach zero and politics constrain traditional fiscal stimulus.⁸

The prospect that regulatory change may increasingly be used as macroeconomic stimulus, particularly during liquidity traps, demands a careful consideration of the effectiveness of this tool. Are regulatory changes an effective policy lever to stimulate aggregate demand and catalyze economic growth and job creation during an economic downturn? Unlike Listokin’s work, this Article focuses on financial regulation, particularly deregulation.⁹ I define “regulatory stimulus” as financial deregulation used as an instrument of macroeconomic policy to stimulate growth during a recession, particularly in a liquidity trap. Working within an efficiency framework, this Article seeks to answer two questions: *first*, whether and when regulatory stimulus is effective in promoting macroeconomic growth, particularly in a severe recession or liquidity trap; and *second*, if regulatory stimulus is effective, whether it is worth the potential tradeoffs in terms of longer-term macroeconomic policy objectives. Ultimately, I find grounds for skepticism that financial deregulation can effectively stimulate economies suffering from a liquidity trap. Moreover, if regulatory stimulus effectively achieves its aims, it may create significant intertemporal tradeoffs. A short-term economic punch can come at the cost of economic institutions that promote long-term financial stability and sustained growth. Accordingly, policymakers should demand clear empirical evidence of deregulation’s efficacy before weakening a particular regulation in an effort to stimulate the economy.

This Article proceeds as follows. Part II sets out a macroeconomic and legal framework for analyzing the effectiveness of regulatory stimulus in providing a macroeconomic boost in a deep recession or liquidity trap. Part III both (a)

6. See Robert Rich, *The Great Recession*, FED. RESERVE HISTORY (Nov. 22, 2013), https://www.federalreservehistory.org/essays/great_recession_of_200709 [<https://perma.cc/8GJ7-KLM3>] (providing dates for the Great Recession).

7. This would reverse the historic trend of financial crises resulting in new and more restrictive securities, banking, and corporate laws. See ERIK F. GERDING, *LAW, BUBBLES AND FINANCIAL REGULATION* 65 (2014) (noting the “regulatory backlash” which follows economic crises); Stuart Banner, *What Causes New Securities Regulation? 300 Years of Evidence*, 75 WASH. U. L. REV. 849, 850 (1997) (“[M]ost of the major instances of new securities regulation in the past three hundred years of English and American history have come right after crashes.”).

8. YAIR LISTOKIN, *LAW AND MACROECONOMICS: LEGAL REMEDIES TO RECESSIONS* 16 (2019) [hereinafter LISTOKIN, *LAW AND MACROECONOMICS*]; Yair Listokin, *Law and Macroeconomics: The Law and Economics of Recessions*, 34 YALE J. ON REG. 791 (2017).

9. The analysis in this Article could be extended, as Listokin does, to reduced enforcement levels.

explains special features of financial regulation that make it the most natural candidate for deregulation designed to provide regulatory stimulus; and (b) discusses how the political economy of financial regulation means that legal interventions for macroeconomic purposes may function as a one-way ratchet to deregulation. Part IV offers a brief case study analyzing whether the JOBS Act was an effective instrument of regulatory stimulus. Part V looks at the other side of the ledger and considers the costs of rolling back securities and banking laws. It argues that the regulation-as-tax metaphor obscures long-term macroeconomic benefits of regulatory infrastructure in fostering investor confidence and building trusted institutions that collect and verify information. Part VI concludes.

II

ANALYTICAL FRAMEWORK

Policymakers who look to regulatory stimulus as a solution to a liquidity trap must do more than just assert that deregulation will spur capital investment or job creation. They need both a macroeconomic and a legal framework for evaluating whether a given regulatory change would have the desired effects and would justify the policy tradeoffs.

A Macroeconomic Framework

1. Fiscal Versus Monetary Channels of Regulation

Before adopting a particular regulatory stimulus, policymakers need to understand and articulate how proposed deregulation would stimulate economic growth. Broadly speaking, regulatory stimulus might act through either a fiscal or a monetary channel. Regulatory stimulus could impact the real economy through fiscal channels by triggering higher levels of spending by households and businesses. Economists speak of this mechanism in terms of increasing “aggregate demand” in the economy.¹⁰ This might occur if the liberalization of securities or banking laws catalyzes greater lending or investment by financial intermediaries. However, relaxing legal constraints on credit or investment does not necessarily mean households or businesses will borrow more or seek more capital.¹¹ Nor does it mean that financial intermediaries will lend or invest more. A good macroeconomic model justifying a particular regulatory stimulus would specify in detail the mechanism by which deregulation would increase spending. It would also specify the economic actors whose behavior would change.

Alternatively, regulatory stimulus might operate via a monetary channel by increasing the stock or accelerating the flow of money in the economy. One type of channel might involve legal rules that allow financial intermediaries to create

10. Listokin’s work focuses primarily on fiscal channels intended to increase demand. LISTOKIN, LAW AND MACROECONOMICS, *supra* note 8, at 6–7.

11. See *infra* Part II(A)(3) (discussing the impact of uncertainty and expectations on the effects of macroeconomic policy).

new private money claims.¹² Another monetary channel might work via a money multiplier effect.¹³ For instance, lowering the amount of reserves that banks are required to hold in a system of fractional reserve banking can exert a money multiplier effect.¹⁴ Lower reserves requirements mean that one bank can lend more to customers who deposit their money in a second bank, and the second bank can then also lend more. The loan from the second bank is ultimately redeposited in the banking system and so forth.¹⁵ Economists and legal scholars have argued that leverage/margin requirements in crucial financial markets, such as those for repos¹⁶ and credit derivatives,¹⁷ operate similarly. When financial market participants post lower amounts of collateral in these credit transactions, the effective money supply grows just as if reserve requirements were lower.¹⁸

In either case, monetary channels may not prove effective in stimulating an economy stuck in a liquidity trap. As with fiscal channels, more permissive legal rules do not necessarily translate into more credit.¹⁹ Looser legal rules do not always mean that financial institutions will create more money claims, borrow or lend more, or consent to counterparties posting lower collateral for financial transactions.²⁰

2. Magnitude and Calibration

For a deregulatory policy to increase aggregate demand or catalyze monetary expansion, its effects must reach a certain magnitude, particularly when the economy is mired in a liquidity trap. For the effects of regulatory stimulus to be deep and widespread, the regulation must not only affect a broad swath of financial intermediaries or investors; it must also induce them to significantly increase lending or investment. However, deregulation may not translate into more credit or investment, as seen in an ongoing academic debate on the effect of capital requirements.²¹ Some economists have questioned the logic that *higher*

12. See, e.g., MORGAN RICKS, *THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION* 93–101 (2015) (hypothesizing that the creation of money claims by financial institutions generated the global financial crisis and other historical crises).

13. N. GREGORY MANKIW, *PRINCIPLES OF MACROECONOMICS* 348–49 (2008).

14. *Id.*

15. *Id.*

16. Tobias Adrian & Hyun Song Shin, *Money, Liquidity, and Monetary Policy*, 99 *AM. ECON. REV.* 600, 604–05 (2009).

17. See, e.g., Erik F. Gerding, *Credit Derivatives, Leverage, and Financial Regulation's Missing Macroeconomic Dimension*, 8 *BERKELEY BUS. L.J.* 29 (2011).

18. *Id.* at 41–42.

19. See *infra* notes 22–23 (describing economist arguments that capital requirements do not necessarily affect bank lending); see also *infra* notes 30–33 (describing how economic uncertainty during recessions may cause economic actors not to invest).

20. I will revisit this problem in the context of expectations and the “pushing on a string” problem. See *infra* discussion in Part II(A)(4).

21. See, e.g., Ben Bradford, *Bank CEOs Ask Congress to Loosen Capital Requirements*, MARKETPLACE (Apr. 11, 2019), <https://www.marketplace.org/2019/04/11/bank-ceos-ask-congress-loosen-capital-requirements/> [https://perma.cc/EJ47-VRPK] (observing that bank executives and academics disagree over whether higher capital requirements stifle lending).

capital requirements necessarily translate into *lower* lending.²² A lower capital requirement allows a financial institution to pay dividends to its shareholders or buy back shares instead of extending credit.²³ In addition, multiplier effects can be very difficult to measure.²⁴ Moreover, policies that stimulate particular asset classes or financial markets may not translate into a broad macroeconomic stimulus, but might inflate specific asset markets, creating bubbles that make economies vulnerable to future crises.²⁵

In analyzing and deploying traditional fiscal and monetary tools, policymakers and economists want to calibrate to have a measured effect, not to merely clear a *de minimis* threshold. Ideally, they want tools that work both ways, so that they can heat up the economy and later cool it down. The macroeconomic effects of changes in legal rules may not be easily-measurable, let alone susceptible to fine-tuning. In addition, as argued below, political dynamics may lead to a one-way ratchet towards financial deregulation.

3. Policy Lag

The time it takes for regulatory stimulus to provide a macroeconomic jolt matters immensely. Even if deregulation exerts a sufficiently large stimulatory effect, the liquidity trap may persist or the recession may have ended. Additional

22. Regulatory capital requirements do not require banks to hold funds in reserve; they merely affect the right-hand side of a bank's balance sheet and the bank's mix of funding. Established finance theory calls into question whether debt or equity financing is more expensive for a bank or any firm. See ANAT ADMATI & MARTIN HELWIG, *THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT* 100, 100–02 (2013) (discussing flaws in the argument that equity funding is more expensive because shareholders demand higher returns than debt holders require).

23. Post-crisis regulatory relief and better bank performance on stress tests enabled banks to pay higher dividends. Lawrence C. Strauss, *Big Banks Are About to Offer Up Higher Stock Dividends*, BARRON'S (June 13, 2019, 9:36 AM), <https://www.barrons.com/articles/big-banks-higher-dividends-goldman-sachs-morgan-stanley-wells-fargo-capital-one-ccar-stress-test-51560370781> [<https://perma.cc/977A-KQ22>].

24. See NICOLETTA BATINI ET AL., INT'L MONETARY FUND, *FISCAL MULTIPLIERS: SIZE, DETERMINANTS, AND USE IN MACROECONOMIC PROJECTIONS 2* (2014) (noting that multipliers are not widely used by economists because they are difficult to estimate).

25. I have written previously about the historical pattern of the relaxation of financial and corporate laws being followed by asset price booms and bubbles in the associated financial markets. GERDING, *supra* note 7, at 48. However, there is an important distinction between an asset price bubble in a particular market and a broader macroeconomic effect. This distinction undergirds the economic arguments against using monetary policy to target asset price bubbles. Raising interest rates, the logic goes, would put a damper on the entire economy with potentially significant spillover costs, instead of narrowly targeting the market that is overheating. See, e.g., Marvin Goodfriend, *Interest Rate Policy Should Not React Directly to Asset Prices*, in *ASSET PRICE BUBBLES: THE IMPLICATIONS FOR MONETARY, REGULATORY, AND INTERNATIONAL POLICIES* 445 (William C. Hunter et al. eds., 2003); Ben S. Bernanke & Mark Gertler, *Monetary Policy and Asset Price Volatility*, FED. RES. BANK KANSAS CITY ECON. REV. 17, (4th Q. 1999) (arguing against using monetary policy to address asset prices and bubbles directly instead of targeting overall inflation). The same logic applies to the reverse situation, namely efforts to stimulate particular asset markets. Providing a jolt to a particular asset market does not necessarily translate into a broader macroeconomic effect.

stimulus may then contribute to inflation risks if the stimulatory effect lags or lingers.²⁶

4. Expectations and the “Pushing on a String” Problem

Expectations and uncertainty can also dampen the effects of regulatory stimulus. Lenders and investors might change their behavior in anticipation of regulatory stimulus taking effect. Alternatively, they might not respond to regulatory changes in the way policymakers intended. Contemporary macroeconomic thought focuses not only on current economic conditions and policies, but also on the expectations of economic actors with respect to future conditions and policies. Expectations can cause behavior to diverge radically from policymakers’ assumptions.²⁷ Regulatory stimulus, Listokin’s “expansionary legal policy,”²⁸ or any other policy in a law and macroeconomics vein must consider whether rule changes are working with, altering, or fighting against expectations about future economic conditions and policies. It is unclear if any act of deregulation would be large enough to change market expectations about the economic future. Regulatory stimulus might have the opposite effect intended by signaling to the market that policymakers have abandoned traditional fiscal stimulus tools with a proven track record.

In addition, lenders and investors might believe that regulatory stimulus will be reversed in the future once economic conditions change, dimming their incentives to commit capital long-term. Economic actors might seek a credible political commitment that the regulatory stimulus will not be quickly undone, eroding the value of investments made in reliance on the policy change. Macroeconomists have debated the effects of policy regime switching in monetary policy, and scholars have advocated simple, mechanical rules to anchor expectations.²⁹ Settling market expectations about the future course of policy may prove harder in the case of complex legal changes.

26. Macroeconomists have long been concerned with time lags in policy, often separating them into “inside lags”—the time it takes policymakers to recognize and decide upon a policy response to an economic shock—and “outside lags”—the time it takes for a chosen policy to have a macroeconomic effect. For very old literature on inside lags, see Patric H. Hendershott, *The Inside Lag in Monetary Policy: A Comment*, 74(5) J. POL. ECON. 519 (1966). For a discussion of outside lags, see, for example, E. Philip Howrey, *On the Outside Lag of Monetary Policy*, 20(2) METROECONOMICA 111 (1968).

27. See generally G.K. Shaw, *Expectations in Macroeconomics*, in CURRENT ISSUES IN MACROECONOMICS 22, 24 (D. Greenaway ed., 1989). For a user-friendly summary of the debate among macroeconomists on the effects of rational expectations on monetary policy, see Flint Brayton et al., *The Role of Expectations in the FRB/US Macroeconomic Model*, FED. RESERVE BULLETIN 227, 227–29 (Apr. 1997) (noting that economists disagree about the basis on which individuals form expectations and about how to model individuals’ expectations).

28. LISTOKIN, LAW AND MACROECONOMICS, *supra* note 8, at 6–7.

29. See, e.g., Andrew T. Foerster, *Monetary Policy Regime Switches and Macroeconomic Dynamics* (Fed. Reserve Bank Kan. City Research, Working Paper No. 13–04, 2014), <https://www.kansascity/fed.org/publicat/reswkppap/pdf/rwp13-04.pdf> [<https://perma.cc/FX46-5569>].

Economic uncertainty also leads to the “pushing on a string” problem, which can afflict macroeconomic policy during (and before) economic downturns.³⁰ This problem arises when investors, firms, and financial institutions are uncertain and pessimistic about the economic future.³¹ Uncertainty may lessen appetites for risk-taking.³² Thus, looser monetary policy may not induce greater spending, investment, or lending.³³ Regulatory stimulus, depending on the channel, may confront the same problem: lowering regulatory impediments to spending, lending, or capital investment may not prompt economic actors to spend, lend, or invest more in the face of uncertainty. In most Western economies, policymakers may lower regulatory restrictions but typically cannot compel investment or lending.

B. Legal Overlay: Types of Regulatory Stimulus

The type of legal intervention may determine the effectiveness of regulatory stimulus. Policymakers can seek a macroeconomic stimulus via deregulation in different areas of the law, or by field. Within the broad field of financial services, policymakers might pursue deregulation in different sub-fields, such as securities or banking law. Different regulatory levers can affect the particular channel for regulatory stimulus, as well as its magnitude and time lag. Rules that directly turn on the spigots for capital investment or credit may prove the most effective regulatory stimulus tools, particularly when that investment or credit catalyzes hiring or other spending in the economy.

Regulatory stimulus can also be classified by the type of policy instrument adopted and by the legal actor that crafted the policy. A country’s legal ground rules clarify what particular policy instruments are available to particular legal actors, governing the process, scope, speed, and duration for any legal change. We can conceptualize different types of legal changes according to a hierarchy of legal process, provided in Figure 1. Actions higher on the hierarchy have more far-reaching consequences, but require more legal process and the involvement of more legal actors representing a larger share of a nation’s polity.

30. See generally Mark Blyth, *The Last Days of Pushing on a String*, HARV. BUS. REV. (Aug. 7, 2012), <https://hbr.org/2012/08/the-last-days-of-pushing-on-a> [<https://perma.cc/RN45-645R>] (noting that banks have been less willing to lend due to uncertainty over the lack of demand in the economy).

31. *Id.*

32. *Id.*

33. *Id.*

Figure 1: The Legal Process Hierarchy

1. Constitutional Changes
2. Legislation
3. Notice-and-Comment Rulemaking
4. Agency Licenses; Agency Adjudications
5. Interpretative guidance
6. Changes in supervisory priorities for regulators

This hierarchy roughly illustrates the tradeoff between the magnitude of effects for a legal rule change and potential time lag.³⁴ Actions on the higher rungs of the ladder may have the broadest and most pronounced macroeconomic effects. However, legal and political roadblocks mean that these changes require the longest time to enact and occur the most infrequently. Moreover, these changes happen at a high level of generality and often require policymakers to implement them via actions lower down the hierarchy.

Deregulation might also be understood along another dimension, namely whether policymakers seek to change the *substance or structure* of a legal rule or whether they seek to change the *quantitative level* of a rule.³⁵ Quantitative changes function more as a knob or dial, whereas substantive structural changes change the architecture of a legal regime. Quantitative rules may have less lag time, but their impact in terms of expectations is harder to predict. Market participants may find quantitative changes easier to understand, which might translate into clearer behavioral changes. On the other hand, participants might doubt how long a quantitative change will last; they may worry that policymakers could easily turn a dial backwards.

III

WHY FINANCIAL REGULATION IS DIFFERENT

A. Clearer Channels

Listokin chose to exclude financial regulation from his analysis of “expansionary legal policy.”³⁶ I take the opposite approach and focus exclusively on financial regulation for several reasons. Financial regulation offers potentially clearer and stronger fiscal channels than the areas of regulation examined by Listokin, given the role of capital markets and financial institutions in capital investment and credit. Financial regulation also opens up potential monetary

34. Some of the rungs in the middle of the ladder may change places depending on context. For example, settlements of adjudications that require the consent only of the regulatory agency and one other party may have less of a time lag.

35. Examples of quantitative rules would be changing the percentage or ratio in margin rules (which determines how much credit can be used for securities or derivative transactions); bank reserve requirements in a fractional reserve banking system; or bank leverage or capital ratios.

36. LISTOKIN, *LAW AND MACROECONOMICS*, *supra* note 8, at 6–7.

channels, given the role of financial institutions and markets in creating money³⁷ and serving as a “transmission belt for monetary policy.”³⁸ The JOBS Act provides an example of regulatory stimulus for analysis.

B. The Political Economy of Financial Regulation and the One-Way Ratchet

Analyzing the effectiveness and tradeoffs of regulatory stimulus requires careful consideration not only of macroeconomic and legal factors, but also of the political economy of the given area of law. Unique features of the political economy of financial regulation mean that regulatory stimulus may act as a one-way ratchet towards deregulation. Fundamental deregulation has been seen as a remedy for a downturn, but few politicians tout re-regulation as a useful dampener for an overheating economy.³⁹ This stems in part from the politics of macroeconomic policy. Few elected officials are willing to stake their political futures on removing the economic punchbowl just as the party gets started. This political dynamic grows stronger in the midst of extreme economic booms and potential asset price bubbles.⁴⁰

Moreover, prudential financial regulation—that is, regulation that aims to mitigate systemic risk or the incidence and severity of financial crises—has a different political economy than many other fields of regulation. In contrast with environmental law, fewer concentrated interest groups favor prudential financial regulation and oppose industry groups pushing for deregulation. Unlike environmental law, where it may be possible to separate noxious effects from economic benefits, it is not obvious to generate more reward without more risk-taking in reasonably-efficient markets. No one likes dioxin. Almost everyone supports credit and investment. Without some engineered interest group pluralism, as with a highly segmented financial services sector or an active plaintiffs’ bar, there is little political pressure to reverse a regulatory stimulus when the economy improves.⁴¹

IV

A BRIEF CASE STUDY: THE JOBS ACT

With macroeconomic and legal frameworks in place, we can sketch a preliminary analysis of whether the JOBS Act represented effective regulatory stimulus.

37. See, e.g., RICKS, *supra* note 12, at 52–62 (discussing the role of banks in money creation).

38. FED. RESERVE BANK OF MINNEAPOLIS, ANNUAL REPORT 1982: ARE BANKS SPECIAL? (1982) https://fraser.stlouisfed.org/files/docs/historical/frbminn/1982_frb_minneapolis.pdf [https://perma.cc/H79Z-UGVY].

39. One exception is price controls. For a history of, and argument against, using price regulation as a tool to combat inflation, see ROBERT L. SCHUETTINGER & EAMONN F. BUTLER, FORTY CENTURIES OF WAGE AND PRICE CONTROLS: HOW NOT TO FIGHT INFLATION (2009).

40. GERDING, *supra* note 7, at 158.

41. *Id.*

A. Channel and Magnitude

Congress did not attempt to specify the channel by which the JOBS Act would have a macroeconomic impact. None of the statutory provisions involve the creation of money-like instruments, nor do they loosen bank reserve requirements or analogous rules. Therefore, Congress did not appear to attempt to use monetary channels to stimulate economic growth through the JOBS Act. This leaves a fiscal channel as the only possibility.

It is hard to specify how the various provisions of the JOBS Act would increase aggregate demand. Parts of the statute (the so-called “emerging growth company” provisions) reduce the periodic disclosure requirements for public companies that have \$1 billion or less in total annual gross revenue.⁴² But it is far from clear how these provisions would induce more spending by these companies. Would emerging growth companies use any saved compliance costs from reduced mandatory periodic disclosure rules to hire more employees or increase capital expenditures? Moreover, not all of the saved compliance costs would count as a net macroeconomic benefit; much of securities law compliance costs constitute payments to lawyers and accountants,⁴³ who would presumably spend much of their earnings. It is difficult to construct a plausible case for lower levels of transparency created by looser financial reporting encouraging more hiring or expenditures.

Other JOBS Act provisions create new exemptions from U.S. Securities and Exchange Commission (SEC) registration for securities issuances conducted in a specified manner—the so-called crowdfunding exemption and the Regulation A+ exemptions.⁴⁴ Proponents of the JOBS Act offered little compelling evidence that liberalizing the legal requirements for securities offerings would lead to greater total capital raising. Moreover, exempt offerings are substitutes for public offerings. Therefore, some portion of additional money raised through exempt offerings might have been raised in public offerings instead.⁴⁵ Furthermore, the various kinds of exempt offerings, including Regulation D, crowdfunding,

42. See, e.g., 15 U.S.C. §§ 77g, 78m (2018).

43. PWC DEALS, CONSIDERING AN IPO TO FUEL YOUR COMPANY’S FUTURE? INSIGHT INTO THE COSTS OF GOING PUBLIC AND BEING PUBLIC 6 (2017), <https://www.pwc.com/us/en/deals/publications/assets/cost-of-an-ipo.pdf> [<https://perma.cc/J957-8WJH>] (providing range of costs of professional services for issuers conducting an IPO).

44. See 15 U.S.C. §§ 77a, 77d(a)(b), 78c(h), 78l(g) & 78o(a)(1) (containing the principle statutory provisions on crowdfunding); *id.* §§ 77c(b)(2)–(5) (listing the Regulation A+ exemptions). SEC registration subjects issuers to an expensive and intensive SEC review of required financial and narrative disclosures that must be given to potential investors before they can purchase offered securities. The SEC can block any sales of securities before it completes this review, and issuers cannot communicate with the investing public while this review is underway.

45. See Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 468–69 (2017) (noting that exemptions from securities regulation have significantly enhanced issuers’ ability to raise private capital).

Regulation A, and Regulation A+, are substitutes for one another.⁴⁶ This means that changing the exemptions for these various rules might simply reallocate capital-raising among different exempted categories instead of increasing the total amount raised. The JOBS Act changes to the different exemptions may have had little effect on the relative attractiveness of exemptions relative to one another.⁴⁷

Further, Congress failed to collect data on how companies actually use the proceeds of exempt offerings. Even if liberalized offerings would lead to greater securities issuances, it is not clear that companies would spend the money to hire new employees or make capital expenditures that they otherwise would not have. Offering proceeds could be used instead to repurchase shares or refinance debt.

The JOBS Act also includes provisions allowing private companies to avoid registering with the SEC and thus avoid mandatory periodic disclosure and rules on proxy contests.⁴⁸ JOBS Act proponents did not produce compelling evidence that private companies would hire more employees or make larger capital investments even if they save on various compliance costs associated with public company status. Proponents of the JOBS Act lauded it for promoting more Initial Public Offerings (IPOs).⁴⁹ The emerging growth company provisions reduce the disclosure requirements for public companies. The statute also allows companies to “test the waters” for an IPO by contacting potential institutional investors without running afoul of the Securities Act. However, the JOBS Act also expands both the ability of companies to avoid public registration and transaction exemptions. The net effect of these rules on IPOs is thus muddled, although some studies do link a spike in IPOs in 2014 and 2015 due to the JOBS Act.⁵⁰ What is clear, however, is that these various provisions of the JOBS Act reduce the overall securities disclosure requirements for companies, despite scant empirical

46. See generally John C. Coates, *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis*, 41 VA. J. INT'L L. 531, 544–49 (2001) (describing the choices of transaction exemptions and SEC registration available to securities issuers).

47. Before the JOBS Act, Regulation D offered perhaps the most attractive set of conditions of all transaction exemptions, as indicated by the sheer size of Regulation D offerings. The amount of capital raised annually through Regulation D alone is larger than the amount raised through public equity and debt offerings. SCOTT BAUGESS, RACHITA GULLAPALLI & VLADIMIR IVANOV, U.S. SEC. & EXCH. COMM'N, *CAPITAL RAISING IN THE U.S.: AN ANALYSIS OF THE MARKET FOR UNREGISTERED SECURITIES OFFERINGS, 2009–2017*, at 4 (2018) https://www.sec.gov/files/DERA%20white%20paper/_Regulation%20D_082018.pdf [<https://perma.cc/J9X7-LCWL>]. While the JOBS Act created new exemptions, it also liberalized Regulation D. For example, the JOBS Act amended Regulation D to allow issuers to conduct general solicitation of investors. Jumpstart Our Business Startups Act, Pub. L. 112-106, 126 Stat. 306, 313 (2012). The net result of the sum of JOBS Act exemptions may have been to entrench further the status of Regulation D as the queen of exemptions.

48. Jumpstart Our Business Startups Act, 126 Stat. at 325.

49. Martin Wellington & Sarah Solum, *On Its One-Year Anniversary, Two Cheers for the JOBS Act*, FORBES (Mar. 28, 2013, 8:00 AM), <https://www.forbes.com/sites/realspin/2013/03/28/on-its-one-year-anniversary-two-cheers-for-the-jobs-act/#3cd6e0f3395c> [<https://perma.cc/J3N4-SA8M>].

50. For one study showing that the JOBS Act did increase IPO volume, see generally Michael Dambra, Laura Casares Field & Matthew T. Gustafson, *The JOBS Act and IPO Volume: Evidence that Disclosure Costs Affect the IPO Decision*, 116 J. FIN. ECON. 121 (2015).

evidence that this increases capital raising, let alone aggregate macroeconomic demand.

B. Policy Lag

Four of the seven titles in the JOBS Act became immediately effective when Congress enacted the statute in April 2012.⁵¹ The other JOBS Act provisions required notice-and-comment rulemaking by the SEC.⁵² Congress included in the Act various deadlines for the SEC to issue final rules implementing statutory provisions. However, the SEC missed many of these deadlines.⁵³ The following chart highlights the timeline for some of the principal rulemakings under the JOBS Act.

Table 1: Policy Lag in the JOBS Act

Statutory Provision	Date SEC Issued Principal Final Rule	Effective Date of Final Rule	Did SEC Meet Statutory Deadline?
Title I: Emerging Growth Companies	Statutory provisions immediately effective		NA
Title II: Regulation D General Solicitation	July 2013	September 2013	Yes
Title III – Crowdfunding Exemption	October 2015	May 2016	No
Title IV – Regulation A+	March 2015	June 2015	No
Title V-VI – Exchange Act (Public Company Registration)	Statutory provisions immediately effective		NA

SEC rulemaking implementing JOBS Act provisions continued even after the final rules listed above. Table 1 shows that, in the case of some rules, the additional outside lag, that is, the time it takes for new macroeconomic policies to take effect,⁵⁴ was *at least* four years, measured from the statute's enactment to the effective date of the final rule. Even for the immediately effective parts of the statute, the associated administrative process still creates a lag. For example, the emerging growth company provisions were intended to facilitate IPOs,⁵⁵ but companies need SEC approval to complete an IPO. Some practitioners estimate

51. *Testimony on "JOBS Act Implementation Update," Hearing on Pub. L. 112-106 before the Subcomm. on Investigations, Oversight and Regulations, H. Comm. on Small Bus.*, 113th Cong. (2013) (testimony of Lona Nallengara, Acting Dir., Div. of Corp. Fin. & John Ramsay, Acting Dir., Div. of Trading & Mkts., U.S. Sec. & Exch. Comm'n), <https://www.sec.gov/news/testimony/2013-ts041113lnjrhtm> [<https://perma.cc/WN7Q-BR8N>].

52. *Id.*

53. Sara N. Lynch, *SEC will miss deadlines on JOBS Act rules-Schapiro*, REUTERS (June 27, 2012), <https://www.reuters.com/article/sec-jobsact-deadline/sec-will-miss-deadlines-on-jobs-act-rules-schapiro-idUSL2E8HRFZO20120627> [<https://perma.cc/M82W-J8T6>].

54. The problem of outside lags has long been recognized in macroeconomics. *See, e.g.*, E. Philip Howrey, *On the Outside Lag of Monetary Policy*, 20(2) METROECONOMICA 111 (1968).

55. Bonnie J. Roe, *IPO On-Ramp: The Emerging Growth Company*, BUS. L. TODAY (May 31, 2012), https://www.americanbar.org/groups/business_law/publications/blt/2012/05/04_roe/ [<https://perma.cc/NFD4-YHUF>].

that SEC review alone can take 10 to 14 weeks.⁵⁶ Many companies must take preparatory steps before the registration process begins, including implementing corporate governance changes and preparing audited financial statements.⁵⁷

C. Expectations and Pushing on a String

Again, relaxing restrictions on capital raising does not necessarily mean that, in the midst of a deep recession or liquidity trap, companies will (a) raise additional capital, and (b) deploy that capital to hire more employees or make capital expenditures.⁵⁸ Reports do indicate that the JOBS Act led to some increases in capital raising via the new or liberalized exemptions. Sixteen months after the final SEC rules implementing the JOBS Act Regulation A+ provisions became effective in June 2015, Issuers requested approval for 147 Regulation A+ offerings seeking \$2.6 billion in financing, and the SEC allowed 81 of these offerings, which sought to raise a combined \$1.5 billion, to go forward.⁵⁹ The SEC also estimated that, between May 16, 2016 and December 31, 2018, there were 1,351 offerings under its new crowdfunding rules.⁶⁰ These offerings sought to raise in the aggregate a “target” (or minimum amount) of \$94.3 million and a maximum of \$775.9 million.⁶¹ An SEC Study on Regulation D estimated that from the 2013 effective date of the rule that allowed general solicitation in certain Regulation D offerings through the end of 2017, only 4% or \$255 billion of all Regulation D offerings relied on this new provision.⁶² That same study concluded that “[c]apital raised through Regulation D offerings continues to be positively correlated with public market performance, suggesting that capital formation in the unregistered market is pro cyclical, i.e., the strength of the unregistered market is closely tied to the health of the public market and the overall economy.”⁶³

The study found an 89% correlation between Regulation D offerings with the S&P 500 index from 1993 to 2017.⁶⁴ It showed a peak in the Regulation D offering

56. Clancy Fossum, *Going Public: The Pre-IPO Timeline*, FIN. EXEC. INT’L DAILY (Mar. 28, 2018), <https://www.financialexecutives.org/FEI-Daily/March-2018/Going-Public-The-Pre-IPO-Timeline.aspx> [<https://perma.cc/9XE9-UUE9>].

57. *Id.*

58. We cannot gauge how successful the JOBS Act was in inducing capital raising during a liquidity trap because many of its provisions took effect via final regulations from 2013 to 2016.

59. ANZHELA KNYAZEVA, U.S. SEC. & EXCH. COMM’N, REGULATION A+: WHAT DO WE KNOW SO FAR? 1 (Dec. 7, 2016), https://www.sec.gov/dera/staff-papers/white-papers/18nov16_knyazeva/regulation-a-plus-what-do-we-know-so-far.html [<https://perma.cc/A3UW-R8VP>]. Note that regulatory filings reveal the maximum amount the issuer sought to raise, not necessarily the actual amount.

60. U.S. SEC. & EXCH. COMM’N, REPORT TO THE COMMISSION: REGULATION CROWDFUNDING 4 (June 18, 2017), https://www.sec.gov/files/regulation-crowdfunding-2019_0.pdf [<https://perma.cc/8S38-XQFY>].

61. *Id.* at 14.

62. BAUGESS, GULLAPALLI & IVANOV, *supra* note 47, at 5.

63. *Id.* at 2.

64. *Id.* at 12.

market in 2007, followed by a fall-off in 2008 during the global financial crisis.⁶⁵ The market recovered to its 2007 level only in 2012.⁶⁶ This finding is consistent with prior academic research showing pro-cyclicality in IPOs and other public securities offerings.⁶⁷ This suggests that firms are less able or willing to raise capital during economic downturns.

V

REGULATION AS TAX VERSUS REGULATION AS ARCHITECTURE

A. An Intertemporal Tradeoff

Beyond the question of whether financial deregulation provides effective macroeconomic stimulus lurk two larger questions: what are the tradeoffs of pursuing financial deregulation; and is pursuing regulatory stimulus worth these costs? The political deployment of regulatory stimulus benefits from a flaw inherent in the “regulation-as-tax” metaphor, which implies that lower “tax rates” (lower regulation) lead to greater economic growth. This overshadows the role that financial laws and regulations play in creating institutions critical for long-term economic development. Deregulation might then trade the uncertain benefits of short-term macroeconomic stimulus for the uncertain costs of compromising long-term legal/economic institutions.

Epidemics of fraud and financial crises reveal this tradeoff, as a wide swath of banking and securities law addresses systemic risk and aims to mitigate financial crises.⁶⁸ Over the long-run, rollback of systemic risk rules may increase the likelihood of future crises, trapping the economy in a vicious feedback loop.⁶⁹ Similarly, weakening antifraud rules risks new epidemics of a financial fraud, which erode investor trust in capital markets. Diluting accounting and financial disclosure rules hinders price discovery and the ability of markets to move past financial crises.⁷⁰ This type of financial deregulation could erode legal and economic institutions.⁷¹

65. *Id.*

66. *Id.* These findings do not necessarily support claims that liberalizing capital markets will spur economic growth during severe market downturns and liquidity traps. Indeed, causation may run the other way.

67. *See, e.g., id.* at 11 (citing Vladimir I. Ivanov & Craig M. Lewis, *The Determinants of Market Wide Issue Cycles for Initial Public Offerings*, 14 J. CORP FIN. 567 (2008)); Hyuk Choe, Ronald Masulis & Vikram Nanda, *Common Stock Offerings Across the Business Cycle: Theory and Evidence*, 1 J. EMPIRICAL FIN. 3 (1993); Michelle Lowry, *Why Does IPO Volume Fluctuate So Much?*, 67 J. FIN. ECON. 3 (2003).

68. *See generally* Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193 (2008) (surveying legal mechanisms to mitigate risk of financial crises).

69. GERDING, *supra* note 7, at 383.

70. Hans Hoogervorst, *Do Not Blame Accounting Rules for the Financial Crisis*, FIN. TIMES (Oct. 3, 2018), <https://www.ft.com/content/bd084b5c-c623-11e8-86b4-bfd556565bb2> [<https://perma.cc/NWX4-J5W6>].

71. *See* YALMAN ONARAN, *ZOMBIE BANKS: HOW BROKEN BANKS AND DEBTOR NATIONS ARE CRIPPLING THE GLOBAL ECONOMY* 22 (2012) (discussing the Japanese relationship with deregulatory

B. Law as Scaffolding for Confidence

The common thread in these different fields of financial law is the importance of investor confidence. It is crucial to move away from the regulation-as-tax view and consider the role of financial regulation in building this confidence. Securities regulators consider protecting investor confidence one of their central missions.⁷² Likewise, for banking law, depositor confidence is the key to preventing bank runs and the systemic risk they pose.⁷³ Removing financial regulations like these so soon after a financial crisis may create additional uncertainty about the trustworthiness of financial institutions, markets, and intermediaries, and further dampen economic activity. Confidence and the macroeconomic role of financial regulation could be rephrased in institutional terms. Securities and banking law create frameworks supporting long-term financial investment. These legal regimes create and support institutions—issuers, capital markets, investment funds and intermediaries, and banks—that serve as trusted generators and repositories of information.⁷⁴

VI

CONCLUSION

The criticisms of regulatory stimulus in this Article should not detract from consideration of macroprudential tools. For example, countercyclical rules protect the stability of individual financial institutions and financial market by regulating more strenuously during market booms when financial risks spike and relaxing during downturns when risks ebb. Automatic rules could address many of the challenges for regulatory stimulus described in this Article. Their automatic application means a shorter time lag, insulation from political pressure, a cure for the one-way ratchet, and a level of understandability and predictability that fosters market expectations. However, countercyclical rules may work less

stimulus, its long-term effects hampering economic growth, and role of accounting rules that delay recognition of losses in creating zombie banks).

72. See Tamar Frankel, *Regulation and Investors' Trust in the Securities Markets*, 68 BROOK. L. REV. 439, 442 (2002); see also Lynn A. Stout, *The Investor Confidence Game*, 68 BROOK. L. REV. 407, 408 (2002) (“[T]here has been much talk among regulators and business leaders of the importance of maintaining investor confidence in the market.”).

73. Deposit insurance together with well-designed bank regulations to counteract the moral hazard created by that insurance are crucial tools for preserving depositor confidence. See generally Giusy Chesini & Elisa Giaretta, *Depositor Discipline for Better or for Worse. What Enhanced Depositors' Confidence on the Banking System in the Last Ten Years?*, 51 J. INT'L FIN. MKTS. 209, 213–14 (2017); Deniz Anginer & Asli Demirguc-Kunt, *Bank Runs and Moral Hazard: A Review of Deposit Insurance 2* (World Bank Policy Research, Working Paper No. 8589, 2018), <http://documents.worldbank.org/curated/en/548031537377082747/pdf/WPS8589.pdf> [<https://perma.cc/2YCL-LHWG>].

74. Some prominent macroeconomics scholarship adopts a similar institutional view. Ben Bernanke shows that the severity of the Great Depression was deepened when banks closed due to the destruction of the valuable information individual bankers had on creditworthiness in their communities. Ben S. Bernanke, *Nonmonetary Effects of the Financial Crisis in Propagation of the Great Depression*, 73(3) AM. ECON. REV. 257, 257 (June 1983).

well as instruments of macroeconomic stimulus, underscoring the potential tradeoff between short-term growth and long-term stability.

Analyzing financial deregulation as a potential tool for macroeconomic stimulus yields important lessons for the larger law and macroeconomic project. First, specifying macroeconomic channels, measuring aggregate impacts, and considering policy lags are essential for evaluating any proposal to use legal interventions as macroeconomic tools. Second, law and macroeconomics must grapple with how the expectations of economic actors regarding future economic conditions or policies can thwart or support legal interventions used as macroeconomic policy. Third, we cannot evaluate any legal rule as an instrument of macroeconomic policy without considering the political economy of that area of law. Politics can blunt, delay, or entrench particular legal changes. In the case of financial regulation, it might create a one-way ratchet towards deregulation. Fourth, it is difficult to identify the macroeconomic impacts of particular legal interventions. Macroeconomics traffics in aggregate data and models, and aggregation may eclipse the effects of micro-changes in legal regimes. Finally, by creating foundations for institutions that collect and produce information, generate investor confidence and trust, and mitigate systemic risk, legal regimes promote long-term growth. Financial regulatory regimes might thus be degraded at long-term macroeconomic peril. Legal rules represent more than mere regulatory taxes that can be repealed as a tool of stimulus.