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The Coming Demise of Deregulation II

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In 1993, I published an article with the rather grandiose title, *The Coming Demise of Deregulation*.² This was an impressionistic discussion of some of the unattractive legacies of airline deregulation—specifically of the bankruptcies of some airlines and their bitter consequences. This, while accurate as to some of the seamier side of airline deregulation and failure, was, I am afraid, far from a convincing demonstration why deregulation of the “regulated industries” would turn out to be a failure and would have eventually to be abandoned. As a matter of fact, this article appeared fifteen years after deregulation (also known in some contexts as “restructuring”) was applied to airlines, was in the process of being applied to telecommunications and natural gas and was about to be applied to electric power. At that time, deregulation, or restructuring, was a mixed success, seemingly appropriate for the rapidly changing technology of telecommunications, apparently incompatible with solvency in the airlines (although seemingly not at risk of abandonment for that reason), not notably controversial in natural gas and not as yet manifesting evident problems in electricity applications. So, at least the title of my article, although potentially prophetic, was strikingly premature on the basis of the existing evidence. A few years later, of course, developments in electricity—leading off with the California fiasco—furnished abundant ammunition for the critics of deregulation, although its supporters were also not slow to rise to its defense.

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California, ever striving to be the leader, had adopted electric deregulation legislation in the middle 1990s, which contemplated full retail choice of generation—the most advanced stage of deregulation. Unfortunately, the results of the deregulation experiment in California were not only unfavorable; they were only slightly short of catastrophic. Not only was there no easing in the price of electricity (which instead rose to record highs), but service was severely impacted, with numerous and extensive blackouts and other forms of power failures. At this point, there was probably still some support for electric deregulation in California, and particularly for its feature of choice of generator, among industrial and other very large users, but whatever support from residential customers it had won was hopelessly lost. The demise of deregulation in California was followed by an upheaval in government—the recall of the governor and the rise of a Hollywood figure to become the new governor. Later, the collapse of deregulation was ascribed to manipulation by Enron and other electric suppliers, which allegedly had employed improper and fraudulent techniques to milk profits from the system. This may have been part of the problem, but the California experience was generally also taken by many to demonstrate the inherent weaknesses of the deregulatory approach even when manipulators were not abusing the system.

More recently, events in the financial arena have eclipsed whatever was happening in the “regulated industries.” In finance, a crisis in the availability of credit has evolved into a severe recession in the economy. In light of this financial crisis, it may behoove us to remind ourselves

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of the principal lessons of our various experiments in deregulation. And, like the catastrophe in
electricity in California, the recent financial and economic disaster has been blamed in
significant part on “deregulation.” There seems to be no doubt that, as a result of the financial
crash, there is a strong likelihood that regulation as a response to economic difficulties will enjoy
a resurgence of popularity, and it is a good guess that this attitude favoring regulation will carry
over into the arena of “regulated industries” and elsewhere and will powerfully affect attitudes
toward regulation generally.

In recent decades in the financial industries, regulation had been treated as a loathsome
disease and, where proposed, had often been rejected in the expectation that market forces and
self-regulation could accomplish the same goals furthering desirable public objectives. These
developments in the financial industries have also been called “deregulation” and have shared
much in common with the equivalent process in the “regulated industries.” Perhaps the most
highly visible of these developments in the financial area was the repeal of the Glass-Steagall
Act, the purpose of which originally had been to keep commercial banking separate from
investment banking, or, phrased differently, to keep the banks out of the securities business. The
repeal of this New Deal legislation permitted commercial banks to acquire investment firms and
to put commercial banks in a dominant position in investment activity. The repeal of Glass-
Steagall was the culmination of a long campaign and removed a well-known restriction having a
broad impact. Responsibility for the financial crisis of 2008 was ascribed in part to consolidation

6 Id.
in the financial area permitted by the repeal of Glass-Steagall.\textsuperscript{8} This was illustrated, for example, by the acquisition of Merrill Lynch, a broker and investment house, by Bank of America.\textsuperscript{9} The latter has developed adequacy-of-capital problems in part from the developing demands of Merrill Lynch. It is interesting to see how the original concern of Glass-Steagall, that banks would dominate the investment business, has now been transformed into a situation where banks are struggling to survive when burdened with the capital demands of an investment firm.

The absence of regulation of certain important credit derivatives—primarily collateralized debt obligations (CDOs) and credit default swaps (CDSs), which were not traded on exchanges and not subjected to regulation was also identified as a key source of instability in the credit crisis.\textsuperscript{10} The primary purpose of the discussion here is to explore the extent to which lack of regulation as an element of the credit crisis may affect the formulation of future regulatory policy rather than to examine in detail exactly how regulation could have avoided the present crisis. This may be a subtle distinction of purpose, but it is important in establishing an appropriate perspective. For there will likely be an irresistible public demand for regulation even without an explanation how exactly earlier regulation could have precluded a past crisis.

It is not difficult to outline the pros and cons of regulation as a theoretical matter in our economy. The essence of capitalism, as expounded by its very early exponent and apologist, Adam Smith, and by many others, was its alleged proclivity to transmute self-interest into the interest of society primarily through the mechanism of competition. According to free market

\begin{itemize}
  \item \textsuperscript{8} Brishen Rogers, \textit{The Complexities of Shareholder Primacy: A Response to Sanford Jacoby}, 30 Comp. Lab. L. \& Pol’y J. 95, 95 (2008).
  \item \textsuperscript{9} See Louise Story, \textit{Stunning Fall for Main Street’s Brokerage Firm}, N.Y. TIMES, Sept. 15, 2008, at A1.
\end{itemize}
theory, the system needed no intervention from the state or other external agent to work toward benign results, which instead were guaranteed by an “invisible hand.” And this remains the view of a very large body of economists. Over the years, their view has been bolstered by scholars who have, without necessarily concluding that regulation is generally detrimental, pointed out various ways in which it can go astray—notably under the “capture” theory, which sees regulation as captive to the interests of the regulated.

Starting from the thesis that capitalism contains benign tendencies that tend to move economies to socially desirable outcomes, most opponents of regulation see it as a retardant force stifling initiative and innovation and inhibiting natural inclinations and, by the same token, good economic performance. On the other hand, advocates of regulation are much less persuaded of the market’s tendency to regulate itself and to automatically provide social benefits. These regulatory enthusiasts see regulation as a crucial imposition of social needs on an otherwise anarchic economic process. Therefore, the debate between exponents of regulation and supporters of laissez-faire tends to remain mired in the fundamental conflict between a benign and a malign interpretation of the basic tendencies of markets.

The one factor that moves opinion back and forth more enduringly between regulation and laissez-faire reflects whether it has been recently invoked in response to a crisis or an ongoing depression, or both, and how it is thought to have performed in restraining them. Thus, as recent economic history demonstrates, many of the regulatory measures that have been recently considered for adoption (and, for the most part, rejected) were offspring of the New

12 Id. at 57.
Deal period, which was a time of severe economic depression following a dramatic economic crisis, when capitalism itself was under scrutiny and regulatory measures were thought to be the answer to every economic problem.

Later, after the period of depression passed and the economic crisis became more remote, the reputation of regulation as a cure-all declined and there came a movement to lighten the hand of regulation, which eventually evolved into a movement for deregulation. As this evolution progressed, the anti-regulatory arguments about the need to stimulate the natural juices of capitalism, which have been described above, once more became dominant academically and the thrust of development in the law moved against regulation. Interestingly, this development equally affected policy in the financial area and in the “regulated industries,” in both of which, as I have noted, the movement away from regulation was called “deregulation.” But, sooner or later, the time came for events to cause the pendulum to begin to swing the other way.

The credit crisis that began in 2007 and gained unexpected momentum in 2008 was notable for one perhaps unusual feature: like a Florida hurricane it gained strength as it advanced. Although some causes could be detected, the full process of collapse that led to an extreme unavailability of credit was surprising. It all seemed to begin with what was called the sub-prime mortgage crisis. A sub-prime mortgage is one assumed by a borrower having a high debt-to-income ratio, an impaired or minimal credit history or other characteristics that are correlated with a high probability of default in comparison with borrowers with good credit history. Typically, this might mean that the borrower in question had a less than reassuring credit history: that is, had a record of multiple bankruptcies or of frequent periods of unemployment or

did not regularly command a salary capable of reliable repayment of the mortgage principal.14

Widespread sub-prime lending was largely predicated on the expectation of rising home prices. The circumstances of a sub-prime mortgage, particularly when home price appreciation is flat or negative could trigger defaults and indicate conditions of higher risk.

Sub-prime mortgages were, of course, frequently introduced in efforts to broaden the market for home ownership and to provide credit to potential home owners who had been earlier precluded by their economic circumstances from home ownership. This sort of mortgage also not infrequently contained adjustable-rate features, where, after applying a low fixed rate for a few years (a “teaser rate”), rates could become variable and escalate sharply for a time.15 In summary, sub-prime lending involves the extension of credit under conditions where the chances of default exceed those associated with normal business practices. This sort of lending practice may, as has been suggested, be associated with a desire to make mortgages more available to a broader spectrum of homeowners or it may simply represent lenders who incur additional risks to increase the volume of lending without a realistic appreciation of the levels of risk. In the recent credit crisis, the risk inherent in sub-prime mortgages began to infect the financial system generally because the mortgages were resold in various forms.16

Whatever regulation was applied to retail mortgage lending has probably pressed lenders

14 Put otherwise, a sub-prime borrower is one with a credit score, or FICO score, between 300 and 850, with a lower score indicating greater risk of default. In addition to having lower FICO scores, sub-prime borrowers typically had loan-to-value ratios in excess of 80 per cent, suggesting a lower down payment. Faten Sabry and Thomas Schopflocher, The Subprime Meltdown: A Primer, 1633 PLI/Corp 89, 92 (2007).
15 Id. at 93.
16 Samuel, supra note 10, at 241-42.
predominantly in the direction of liberality—of making mortgages more available to more home owners, not of reducing the chances of default. Legislators might well have concluded that the self-interest of lenders would have moved them to tighten mortgage practices, so it is not clear what increased regulation would or should have done to forestall default and foreclosure, except to increase truth and accuracy in promotional statements and activity. Nonetheless, since these initial defaults at the retail level first introduced the potential for increased risk into the credit system, regulation seeking to forestall defaults would be helpful in precluding a credit crisis. Such regulation would be in the interest of the consumer as well as of the lender to the extent that it helps to reduce the risk of default and foreclosure—neither a benefit either to the borrower or to the lender.

But, of course, credit crises do not arise out of isolated defaults in mortgage loans alone; they are basically the product of suspect credit at various points in the financing system and with respect to various institutions involved in the financing process. When banks or other savings institutions enter into mortgage loans, they typically do not retain them but transfer their risk to other financial institutions through the process of securitization. Securitization is the creation and issuance of debt securities whose payments of principal and interest derive from cash flows generated by pools of assets—in this case of home mortgages. Securitization is not new, but its widespread application to home mortgages, and to sub-prime mortgages in particular, has been widely cast as the villain in the recent financial crash. In this process, home loans are “pooled,” which is to say that thousands of mortgages are placed in trust, and securities backed by these mortgage pools are sold to investors.17 Mortgage-backed securities (MBSs) are in some respects

17 See, e.g., Roberta Romano, A Thumbnail Sketch of Derivative Securities and Their
like derivatives (because their yield is based on the value of another asset) but they are not true derivatives.\textsuperscript{18} Mortgage-backed securities, in turn, were “re-securitized.” That is to say, they are purchased by new special purpose entities, which issue so-called “collateralized debt obligations” (or CDOs) backed by specific classes of mortgage-backed securities.\textsuperscript{19} CDOs are true derivatives.

The issue of risk thus became central and came to dominate the behavior of the various parties in the financing process in hedging or offsetting their own risk, or in at least attempting to appreciate it with an adequate degree of confidence. In the case of cash flow CDOs created from pools of bonds based on mortgage loans of varying degrees of risk, the debt might be split into pieces by issuing new securities linked to each piece. Some of the pieces are of higher quality and some of lower. Credit-rating agencies give investment-grade ratings to most or all of these so-called “tranches,” with the exception of the most junior “equity” tranche.\textsuperscript{20} Possibilities exist here for the mispricing of risk either by credit rating agencies or by hedge funds and other sophisticated investors, which are able to manipulate the pricing and structure of CDOs. CDOs are an opaque market dominated by a handful of interests. They pose systemic risks, including

\begin{itemize}
  \item \textit{Regulation}, 55 Md. L. Rev. 1, 69 (1996).
  \item \textit{Id.} at 74.
  \item \textit{Id.} at 74.
  \item \textit{Id.} at 1386.
  \item \textit{Id.} at 1386.
\end{itemize}

the risk that a default on one or more bonds will generate a ripple effect of defaults in CDOs.\textsuperscript{21}

The extensive credit crisis that we have undergone, based initially on sub-prime mortgages, was the cumulative product of the effort of banks and other financial institutions to provide home mortgage and other financing and to diffuse risk through the participation of other institutions and sources of credit. Apparently, in the workings of this process, the most dangerous and unacceptable condition was the undertaking of unknown or unmeasured risk. The possibility of encountering uncalculated risk induced financial institutions to refuse credit to new borrowers or to decline to accept risk from a suspect quarter. The financial institutions were, as noted, in the process of hedging their own risks–of attempting to transfer all or part of those risks to other parties. But this sometimes led to their being exposed to new or unknown risks.

In addition to CDOs, another credit derivative which has played a major role in the financing process is the credit default swap (CDS)–a private contract in which private parties place bets on the probability of a borrower’s bankruptcy, default or restructuring.\textsuperscript{22} In a sense, this is insurance against a bad credit event of a borrower. Thus, a financial institution which makes a loan and wishes to hedge its risk enters into a CDS with a third party with respect to the credit of the party to whom it has made the loan. In the event of a credit-impairing event, payment by the CDS protects the financial institution against loss on the transaction.\textsuperscript{23} CDSs may sometimes be acquired for non-hedging purposes, essentially as speculative vehicles in their

\textsuperscript{21} Partnoy & Skeel, supra note 19, at 1040.

\textsuperscript{22} Id. at 1021.

\textsuperscript{23} Id. at 1021-22.
own right—a practice perhaps especially ripe for regulatory control.24

Through the use of CDSs, it is not necessary to buy any actual bonds or mortgage-based securities in order to create what are called synthetic CDOs.25 These are created by aggregating credit default swaps based on whatever securities are intended, so that, if and when the banks, for example, run out of mortgage-based securities, they can sell synthetic CDOs to investors.26 It has been the practice of some banks to retain MBSs on their own balance sheets and to buy protection against default by these MBSs through the purchase of CDSs, and then to sell synthetic CDOs to investors. These transactions, however, are essentially variations on basic hedging operations, and have added little fundamental to the process but may represent a high volume of transactions.

A little something further might be said about CDSs, since these have become so pervasive in the modern credit system and, together with other credit derivatives, have been called “financial weapons of mass destruction.”27 The benefits of CDSs as hedging mechanisms have been widely proclaimed by Alan Greenspan and others and they have helped to act as shock absorbers in some of the recent corporate crashes.28 Many of the lenders to Enron and others had heavily hedged their risks, so that, with the failure of the borrowers, the corporate

25 Partnoy & Skeel, supra note 19, at 1022.
26 Id.
28 Id. at 1023-24.
scandals did not spread to the banking industry. Systemic benefits such as these persuaded Greenspan that the market in CDSs should not be regulated but should remain unfettered and encouraged to grow. Other observers felt that credit derivatives and other risk management techniques provided new opportunities for the banking industry, which could deal easily with ordinary risks such as interest rate risk and, therefore, focus fully on more complex borrower-specific risk.  

Later, after the crash, Greenspan partially recanted, saying, “The whole intellectual edifice, however, collapsed in the summer of last year because the data inputted into the risk management models generally covered only the past two decades, a period of euphoria. Had instead the models been fitted more appropriately to historic periods of stress, capital requirements would have been much higher and the financial world would be in far better shape today, in my judgment.”

Thus, practices based on successful experience of high risk-taking did not provide protection in more sober circumstances.

By lowering the risks of bank lending, CDSs increase the liquidity of the banking industry. This effect is similar to the impact of securitization on home mortgage lending. The

29 Id.


31 Besides these basic credit derivatives, certain instruments provide a wide variety of variations on these basic conceptions, with new innovations being introduced all the time. For example, there is the target annual review not (TARN), where capital is invested in a portfolio of positions and the goal of the investment is the achievement of a target rate of return. In constant proportion portfolio insurance (CPPI), the investor is theoretically protected against loss, but still able to participate in gains. Then there are constant proportion debt obligations (CPDOs) where a special purpose vehicle is created, which issues highly rated bonds with long maturity dates, and the money is invested in a pool of assets as collateral. See Lynch, supra note 13, at 1387-89.
ability to sell a mortgage sharply reduces the risk of undertaking it in the first place, and risk-reduction is the key to volume in mortgage placement.\textsuperscript{32} But all these, and other, advantages in CDSs and other credit derivatives can also reveal potential sources of danger when viewed from other perspectives. Two of these problems arise from the disincentives which, for example, CDSs offer to financial institutions in the monitoring of borrowers and from the opacity of the CDS market.\textsuperscript{33} Enron is cited as an example of loss of incentive to monitor and oversee a customer through massive hedging of loan debt. Enron borrowed billions of dollars from some of the country’s leading banks but these amounts were hedged by what is estimated to have been 800 swaps. Presumably, for this and other reasons the creditors provided little direction to the floundering energy upstart. Obviously, financial backers would prefer to have their wards survive and flourish but, with enough hedging of the debt, the creditor’s anxiety is bound to be muted.\textsuperscript{34} It is not easy to see how this particular effect of the use of CDSs could be reversed or improved by regulation but the existence of a regulatory authority might play a role in keeping a financing agency awake and alert to the activities of its client.

Opacity is a different matter since disclosure is usually at the heart of securities’ regulatory philosophy. The hidden character of hedging is an obvious outcome of the use of CDSs. There is no way for the outside observer to know whether a given financier’s risk is hedged or, in a complex arrangement, what entity bears the ultimate risk.\textsuperscript{35} The International

\begin{itemize}
\item \textsuperscript{32} Partnoy & Skeel, \textit{supra} note 19, at 1024.
\item \textsuperscript{33} \textit{Id.} at 1032, 1036.
\item \textsuperscript{34} \textit{Id.} at 1032-33.
\item \textsuperscript{35} \textit{Id.} at 1036-1037.
\end{itemize}
Swaps and Derivatives Association has actively resisted the disclosure of credit default swap documentation and has insisted that that information is proprietary.\textsuperscript{36} In addition, one party to a swap frequently sells its interest to someone else without notifying the other party to the arrangement. “Record-keeping, documentation and other practices have been so sloppy, that no firm could be sure how much risk it was taking or with whom it had a deal.”\textsuperscript{37} All this opacity leads to significant problems in interpreting the behavior of other actors in the market. For example, if a lender makes concessions, it may mean one thing if that party is fully hedged and quite another thing if the lender is unhedged. The opacity of the market may also make it more likely that hedge funds or other parties will manipulate default in various ways to the detriment of stability.\textsuperscript{38}

Before leaving the financial crisis and its implications, it would be appropriate to mention the savings and loan crisis of a somewhat earlier period. In part, this crisis was based on the lifting of limitations placed by law and regulation on interest payable on deposits in savings and loan institutions. These limitations made it difficult for these institutions to compete with banks, which had been freed of such limitations, for deposits. However, when the limitations on the savings and loans were removed and these institutions raised their interest payments, they correspondingly raised their revenue requirements and they began to search for more profitable investments than the home mortgages in which they traditionally invested. Of course, in line with normal expectations, pursuit of more profitable investments implied acquisition of riskier investments and for the savings and loans this meant investments in commercial development

\textsuperscript{36} Id. at 1036. Id. at 1036 (quoting David Wessel, \textit{Wall Street is Cleaning Derivatives Mess}, WALL ST. J., Feb. 16, 2006, at A2).

\textsuperscript{37} Partnoy & Skeel, \textit{supra} note 19, at 1036.
projects, hotels, resorts and the like. When times turned bad, this meant higher losses and a crisis in the industry attributable in part to a relaxation of regulation—not unlike the current credit crisis.

All this leads us to wonder whether a monstrous tide of regulation is coming back to the American financial system like the ocean tide to the Bay of Fundy. Examination of the technical details of credit derivatives and their usefulness or dangerousness does not provide an answer. We know that the economic setback following on the credit crisis of 2008 has been and will continue to be stunning. We know, as described earlier, how that crisis grew out of the burgeoning use of credit derivatives following on a vigorous placement of sub-prime mortgages. What we don’t know for sure is whether aggressive government regulation of either the mortgage business or of credit derivatives could have avoided the problem or at least weakened its impact. Following well-established precedent in the securities laws, effective regulation could, at least, have required transparency and eliminated the mystery that enshrouds the present use of credit derivatives. More effective regulation could also have affected reserve requirements based on risk. But, at this point, there is no unanimity as to precisely what sort of regulation is required.

Most commentary on regulation of credit derivatives puts it within the context of securities regulation in general and emphasizes the need for centralization of responsibility and for increased efficiency, usually to make the industry in the United States more competitive with its counterparts elsewhere.39 And most regulatory proposals rely on self-regulation and sometimes refer to guidelines laid out by the Major Dealers in meetings held to discuss

39 Lynch, supra note 19, at 1431-35.
improvements in the infrastructure of the industry.\textsuperscript{40} But the dire circumstances under which regulation now may become an active issue seems to rule out any major reliance on self-regulation. After numerous failures on Wall Street requiring bail-outs\textsuperscript{41} and the Bernard Madoff scandal, there is little likelihood of any enthusiasm for committing regulation of Wall Street to the tender mercies of its denizens. It seems more likely that Congress would put arms-length regulators without strong ties to the Wall Street operators in charge.

Returning at last to the status of regulation in the “regulated industries,” we find that after California, the push to deregulate in the electricity sphere lost force. In some states efforts went forward with vigor; in others there was a slowdown or freeze and little effort to press on with restructuring. In a few places, there was even some backsliding and withdrawal from arrangements already tentatively undertaken as steps toward deregulation. These tendencies were not entirely the result of the well-publicized failures in California, but that was certainly a turning point in a movement which, up to then, had things going pretty much its way.\textsuperscript{42} At that point, deregulation or restructuring seemed to be most successful in applications where few natural monopoly characteristics were in evidence and capital intensiveness was not overwhelming, such as trucking and the airlines. In these applications, the economic characteristics of the activity seemed alien to efforts to prescribe prices and services administratively and these could be left to private arrangements between shipper or passenger and the carrier, with competition to enforce reasonableness. Currently, deregulation of the

\textsuperscript{40} Id. at 1396-1405.


airlines seems successful in terms of route structure, fares, flight frequency and other traditional concerns. The only major problem is that the airlines, taken as a whole, seem incapable of making money. In 1938, the same deficiency was a prominent factor in the imposition of regulation. Presently, there is no clamor for re-regulation, but this might be reimposed if all else fails. Presently, the price of fuel seems a dominant element in financial performance, but the ultimate impact of this is unpredictable.

On the other hand, in heavily capital-intensive industries where natural monopoly characteristics had traditionally been emphasized—like electricity—restructuring to emphasize choice and competition seems to have been least obviously and consistently successful. In industries lying somewhere in the middle of this range of characteristics—like telecommunications, where innovative technology is prevalent—restructuring has been carried out with claimed success but not without some major difficulties. Natural gas is another industry where an approach favoring competition has been workable.

In light of this mixed performance, there seems to be no compelling reason why dire circumstances involving credit derivatives in the financial industry should re-awaken interest in re-regulating the formerly “regulated industries.” The best answer is that in popular parlance and understanding both these areas of regulatory activity had been subjected to “deregulation.” This was literally true in the case of “regulated industries.” Here, control of price and service by regulatory agencies had indeed been lifted on a broad basis with the degrees of success and failure that I have noted. However, credit derivatives were never regulated because they were not

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traded on an exchange as were, for example, futures and options (also derivatives). So credit
derivatives had not been literally “deregulated” although the term was extensively applied to
them after the credit crisis arrived.

That there will be strenuous efforts to regulate credit derivatives and anything else
connected with the credit crisis seems virtually certain, and I would anticipate the regulatory
tide’s lifting all boats, including the one supporting the “regulated industries.” The era of
deregulation is over and the sentiment that it is more important to let the juices of capitalism
flow than to be sure they are flowing in precisely the right channel is no longer dominant. The
pendulum has swung from the extreme of liberation to the extreme of restraint and the ideology
of the New Deal will be ascendant. This is almost sure to be the reaction to a widespread collapse
of the economy based in part on negligence and in part on greed. There will probably be less
concern with the specifics of exactly what is to be regulated (although transparency is a likely
candidate for high priority) than simply a demand for a stern regulator to be in charge. In the
case of credit matters, the most popular proposal is to list CDOs and CDSs on an exchange and
require the reporting of all trades. This would supply complete transparency. There is also
great interest in altering the compensation arrangements of credit-rating agencies to eliminate

44 Id. at 1375-80.

45 See Lynch, supra note 19, at 1434-36 (recommending the creation of a single regulator to oversee all U.S. financial markets that delegates the responsibility for developing rules and best practices, by which each market operates, to market participants); see also Samuel, supra note 4, at 256-57 (advocating a flexible regulatory system that promotes full disclosure and results in severe penalties for non-compliance).

conflicts of interest. And, as indicated, I suspect that the newfound popularity of regulation will be felt almost equally in what were traditionally known as “regulated industries.” This is perhaps not as certain, but public psychology being what it is, disillusionment with “deregulation” should sweep across the board and reach far beyond financial matters, and even into unrelated areas like food processing, as exemplified by the recent “peanut salmonella” scandal. The impulse to apply social restraints will generally outweigh the demand to unshackle the dynamics of markets.

The deregulation movement in all its forms was energized for many years by academics and others deeply persuaded of the Adam Smith thesis that the operation of competitive markets worked to further stability and socially beneficial economic outcomes. This broad school of thought regarded intervention in markets as generally undesirable and disruptive of the natural equilibrium that markets tended to achieve when undisturbed. Carried to an extreme, this non-intervention school of thought would have eschewed tinkering, even to repair the damage of a major crash leading to an abrupt recession. Just as these laissez-faire advocates stepped back from vigorous measures to stimulate a lagging economy (à la Keynes), they would be suspicious of a regulatory regime designed to guide an economy around the shoals of crisis and slowdown. The same tendencies apply to the “regulated industries” where the deregulators want nothing to interfere with the natural and self-restorative rhythms of the market. But all of these sentiments are bound to fall before the harsh realities of a major credit crisis leading to a depression. Just as deregulation, based on a deep faith in markets, has dominated theory and practice in all areas for so long, now terrible damage to the economy has destroyed the underlying faith and replaced it with a penetrating mistrust.

This is certainly not to say that the swing toward regulation will last forever. Once the
crisis is passed and remains passed for a long time, the beauties of laissez-faire will again be visible and influential. But that is a day beyond this one and far beyond it at the moment, and the old and somewhat shopworn arguments against regulation will fall on deaf ears. At last fulfilling the forecast in 1993, the demise of deregulation is now virtually guaranteed.