



Commentary

### **Deregulation Democrats?**

Paul Danos 03.07.07, 4:00 PM ET

If you took a quick look at the results of November's election and began anticipating an increasingly burdensome regulatory environment for business and finance, you could probably be forgiven. After all, most politicians have traditionally divided roughly on party lines when it comes to issues like legal and regulatory policy, and the Democrats swept the table in 2006.

But three powerful pendulums are at work in the American economy, and it is a safe bet that the politicians will be more intent on preventing further erosion in our capital markets' competitive advantage than on sticking with traditional party lines.

The first pendulum is the legal environment, and this is the heaviest of the three (meaning it is slow moving and has a very, very long stroke). Discussions over legal reforms have been ongoing for years, and there have been plenty of arguments about the burdens of our legal structure. There is no question that large firms can be deeply vulnerable if even a small portion of their activities are called into question, and the generally litigious nature of our society demonstrates that the legal pendulum is near an apex--and not likely to change anytime soon. Ultimately, this pendulum is generally less influenced by what happens in Washington and more affected by the cumulative weight of decades of case law. It is rarely affected in any significant way by administrative changes.

The second pendulum, made up of financial and regulatory issues, operates on a shorter stroke and has seen a new burst of activity that started with Enron and the resulting Sarbanes-Oxley legislation. This is an area where the politicians can have an immediate impact when they want to, and it is a pendulum that is also near its apex. The U.S. Securities and Exchange Commission set the gold standard as the best regulatory body in the world. Over the course of 60-plus years, it created an orderly market that was the envy of the world.

But the pendulum has continued swinging in the same direction, and today I believe most people think Sarbanes-Oxley and some other recent developments, combined with the legal arena, are creating an oppressive regulatory regime where there are simply too many easy ways to get sued, lose your reputation, get a serious political black eye or get stuck with significant fines.

The third pendulum is the availability of viable alternatives to our country's public markets--specifically, privatization and foreign capital markets. Market conditions

such as the availability of cash and the booming debt markets are allowing leveraged buyouts with less and less equity, and as a result we've seen significant growth in fund size, deal size and frequency of privatization.

In the public markets, we've also seen a steady rise in the ratio of IPOs taking place overseas, compared with here in the U.S. Overseas capital markets in places like Singapore, Shanghai and parts of Europe are now big enough, sophisticated enough and have the sufficient legal structure to attract the business that America used to dominate. And, of course, these markets know that it is in their interest to have more liberal regulatory and legal environments than we do, because it significantly enhances their appeal.

Each of the three pendulums--the legal environment, regulatory regime and the alternatives to our public markets--is at or close to an apex. The result is that some pain is going to come at a very high level, in the big numbers such as how much traffic goes through our markets as compared with the rest of the world. Now, with globalization, it is inevitable that we will lose some of our edge in a world where other countries are rich and can pick and choose which of our laws to duplicate. But the combined weight of these three pendulums is speeding up this process when we should be slowing it down instead.

This isn't going to go unnoticed by the politicians, and the realities of politics at the local level will dominate where people land on this. The pressure created by the eroding competitive advantage of the American capital markets will be felt first in places like New York City and Chicago, and its impact will quickly translate into policies being advocated by the officials who represent them (by and large, Democrats). Already, there is talk of revisiting Sarbanes-Oxley, revisiting some kind of tort reform and other proposals. Politicians that you'd never expect, like U.S. Sen. Charles Schumer, D-N.Y., or New York Gov. Eliot Spitzer, are talking about potential approaches to deregulation, because they understand that they ultimately need to protect their constituents.

No one can predict the extent of these coming pressures or how far the pendulums will swing, but if the rate of privatization continues to grow and/or the non-U.S. financial markets continue to take a larger share, we could see major changes in our public markets. When the impacts of these forces are more clearly felt, one clear path that might be taken is to aggressively cut unproductive financial regulations and to reform parts of the legal system.

So don't be entirely surprised if a coalition emerges made up of some liberal Democrats as well as some conservative Republicans, intent on making our financial and business environment more competitive by removing some of these burdens.

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