

Capitalism, Capital Markets and Regulation

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Course Overview

The economic efficiency of capitalism is well understood by economists. However, this traditional economic analysis does not extensively consider the complications that occur as firms grow and access outside capital. In particular, important issues arise for (1) firms where ownership and day-to-day control are separated and (2) when a market for publicly traded securities are traded. This course covers the economics of (1) firms that access outside capital and (2) the regulation of capital markets. Particular emphasis is placed on current issues.

Topical Coverage

The following lays out the topical coverage in the course and some tentative readings.

Efficiency Arguments for Capitalism

The key concepts are (a) Pareto efficiency, (b) economic incentives and (c) information production and aggregation under capitalism.

Invisible Hand – Adam Smith

Free to Choose – Milton and Rose Friedman

Knowledge and Decisions – Thomas Sowell

Moral Arguments for and Against Capitalism

The key concepts are (a) economic efficiency as an ethical criterion, (b) objectivism and individual autonomy, and (c) relations between economic and political freedom.

A Theory of Justice – John Rawls

Atlas Shrugged – Ayn Rand

Regulation of Financial Institutions

This section applies traditional economic arguments on the role of regulation to the regulation of financial markets and institutions.

Luigi Zingales, 2004, “Costs and Benefits of Financial Market Regulation,” ECGI Working Paper

Restructuring Regulation of Financial Institutions, Barth, Brumbaugh and Yago.

Craig Doige, Andrew Karolyi and Rene Stulz, “Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time,” Unpublished Manuscript, Ohio State University.

Property Rights, Regulation and Economic Growth

This section examines the evidence on how property rights and levels of investor protection influence capital formation and economic growth across countries

Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer and Robert Vishny, 1997, "Legal Determinants of External Finance, *Journal of Finance*, 52: 1131-1150.

Capital Markets and the Separation of Ownership and Control

This section examines the inevitable problem facing large firms: the management of the firm is in the hands of individuals with small shareholdings. Specific topics include the role financial leverage, management compensation and active shareholders.

Adolf Berle and Gardner Means, [The Modern Corporation and Private Property](#)

Michael Jensen, "Agency Cost of Free Cash Flow, Corporate Finance and Takeovers, 1986, *American Economic Review*.

Jesse Fried and Lucian Bebchuk, [Pay Without Performance: The Unfulfilled Promise of Executive Compensation](#)

Laura Starks and Stuart Gillian, "The Evolution of Shareholder Activism in the United States, Unpublished Manuscript, University of Texas