

Regulating Corporate Behavior for the Public Good
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Background

The course focuses on providing students with an understanding of how business responds to regulations, shifts in legal liability and other forms of policy incentives (e.g., taxes and subsidies) and with tools to bring those responses into better alignment with policy goals.

Corporations pose special challenges and opportunities for policymakers due to the extreme mutability of corporate organization and behavior. Products, target customers, production methods, services, locational structure, organizational design, legal formalizations and even corporate identity are all subject to rapid change. Policy interventions that seek specific social impact have can have their impact derailed or magnified by these often-unanticipated responses. Further, even if policy interventions succeed at the firm level, external competitive forces will often generate changes in the marketplace that go well beyond the choices of the current corporate incumbents. The course will focus on (1) understanding real world processes that generate these corporate responses; and (2) how regulations could have been designed such that these real-world outcomes would have come closer to the regulator's original intent. We will also carefully look at the inherent trade-offs in policy designs to help understand how regulators can set more realistic goals. We will look at a large variety of policy areas including financial, environmental, health, labor, and inequality.

While inevitably there will some discussion of what the goals of policy should be, we will be mostly concerned with regulatory design and outcome. The course will generally take policy goals as given and appropriate. However, the study of real-world trade-offs in policy design will lead to some discussion of better vs. worse outcomes that will require at least some discussion of the goals themselves.

The course is structured in six modules starting with a 1.) broad assessment of natural and economic systems and then a sequence of modules looking at specific types of adaptive behaviors (2.) firm level economic responses, 3.) firm level legal and accounting responses, 4.) industry level adaption/evolutionary responses, 5.) financial market responses) and then 6.) a final module on climate policy interventions using the combined tool set with a special emphasis on selecting the right tool for the policy problem. Each of the response modules will provide background and tools for forecasting such responses as well as methods for altering policy to create better alignment between those responses and policy intent.

Every module will cover both theory and real-world examples of both policy success and failure. Lecture notes on the policy methods and tools, but not examples, will be supplied to students at the beginning of each module. Key applied and background readings are flagged in the module summaries. Applied readings are required. Background reading are meant to help students who find them useful. Some of the background readings are quite technical but are designed to provide the student with an accurate understanding of the types of material used by those who advise corporate managements, not to provide the needed technical skills to provide that advice. The required technical tools (mostly applied option theory) for the class beyond basic price theory and probability will be covered in lectures.

Additional background readings will be distributed during the term once they can be appropriately framed.

Goals of Class

The goal is to provide students with a broad systems level understanding of good policy design in a world in which private sector entities—corporations, partnerships, and even sole proprietorships—have their own objectives and respond to their own incentives, thus potentially frustrating the best-intentioned policies. The emphasis will be on understanding the nature of corporate response, not on the technical mastery of any given set of analytical tools. Specifically, students completing this course will be able to:

- Analyze and explain how actual policies affected business incentives and behavior across a variety of policy domains, including health, energy, and financial markets
- Assess the potential impact of proposed policies on short- and long-term business decisions and industry structure, identifying the potential tradeoffs faced by policymakers
- Identify ways in which policymakers can set and meet more realistic objectives in a setting characterized by significant, complex, and sometimes oppositional corporate reactions and response to policy

Course Prerequisites

All second year Harris students who have completed the core sequences in microeconomics and statistics/econometrics are eligible.

Class Logistics

The class will meet twice per week. Class time will be devoted to lectures, student presentations and discussions. Remote attendance is allowed, but as a major portion of the class is discussion of examples, majority in person participation is recommended.

Student Expectations and Assignments

Students are expected to participate in class discussions of policy implementations throughout the term. Further, three specific assignments must be completed, with grading weights as indicated¹:

- Individually-authored policy brief and presentation on a specific policy implementation (15%). This can also serve as a final paper proposal.
- Group presentation on how to improve a specific policy implementation (35%)
- Individually-authored final paper (8 page maximum) on a policy topic of their choice (50%)

Commented [PW1]: Suggest word limit instead. Will share separate example of written assignment I have used.

¹ If an individual presentation for a student is impractical, grading weights will be 40% group presentation and 60% final paper. If a group presentation is impractical final paper will 85% and individual paper much be a final paper proposal.

- This final paper may build on the group or individual presentation, and it should assess at least two different approaches to reaching a desired result.

All work products need to be reviewed with the instructor prior to completion:

- Individual policy briefs and presentations should be proposed to instructor by email to allow comment before presentation.
- Group presentations and final papers must be outlined in writing and reviewed with the instructor (in person when possible) before completion. Groups will be formed around common policy interests by the students themselves.

Outline of Topics

1. Module 1: Systems – Natural and Economic systems

We look at business both as a natural and economic system to provide guidance on switching between these views depending on policy questions. We will also review how these approaches relate to the “problem of the commons” and Coase’s theorem. Obamacare will be used as the motivating example.

2. Module 2: The economics of product design

Firms can change what and how they sell products and services. As a result, attempts to alter corporate behavior by simple regulatory constraints often change the offered products in ways that are unanticipated by regulators, and which reduce (or even reverse) the intended impact of the regulations. We look at alternative regulatory approaches that better align economic incentives with desired and policy outcomes, primarily through altering fixed cost aspects of the problem. This module also briefly reviews the meaning of shadow prices embedded within economic optimization frameworks and the implied incentives for corporations to innovate around those constraints. The module will also contain a discussion of tax incidence to provide a context to understand the impact of how these changes impact different groups. Automobile mileage standards will be used as the motivating example.

3. Modules 3: Legal and Accounting responses

Regulations often create strong incentives to change the legal forms of “exposed” firms. These changes can have profound impacts on the behavior of companies in ways that are hostile to regulatory intent. We look at both the range of legal and accounting responses available to firms and the fundamental changes in corporate behavior these actions can generate both with respect to and beyond the regulation. In particular, we look at how capital rules and legal exposures alter incentives for care and innovation and the ways in which these trade-offs constrain policy. This section will focus on liability rules though tax rules will be covered. (Legal readings in this section will be provided during the module to provide context.) Post-financial crisis sub-prime lending will be used as the motivating example.

4. Module 4: The Competitive Response

This module focuses on the regulatory impact on industrial structure. Many policies are based on fixed industrial structure and on management intent. Competitive systems are not fixed in structure and do not have intent. This disconnect leads to situations where regulations can radically change the way industries are structured by creating strong incentives to innovate around rules when “desired outcomes” are unprofitable. We look at how industries evolve naturally and how regulators can create pressure to “evolve” in socially positive ways. This module will contrast the negative evolutionary pressure that was created in sub-prime lending market post the financial crisis to the positive evolutionary pressure that was created by Obama care insurance pools. We will also look at how technology has changed media and the evolution of “niche” providers in news and programming to make it easier to understand that these “regulatory” responses are not in fact “regulatory responses”, but business responses and are embedded deeply within business practice and essentially inescapable. Research and development in the drug industry will be used as the core motivating example, but Obamacare, sub-prime lending, and modern political media will all be discussed.

Commented [PW2]: I like modules 2, 3, and 4 and think of them somewhat holistically as working through short-run responses of firms all the way to long-run industry/sector level responses (changes in business form, entry/exit, etc.). The key concepts of **elasticity and mobility** can tie some of these things together.

Commented [PW3]: Work by people like Owen Zidar et al. fits nicely here; there are research papers (NBER) as well as BFI “policy briefs” (good for limiting technical demands). Smith, Matthew, Danny Yagan, Owen Zidar, and Eric Zwick. “The Rise of Pass-Throughs and the Decline of the Labor Share.” Research Brief. Becker Friedman Institute, November 2021.
https://bfi.uchicago.edu/wp-content/uploads/2021/11/BFI_RB_Zwick_113021.pdf.

I suppose the movement of intellectual property (IP) to foreign jurisdictions to limit tax liabilities of US-based multinationals fits in here too?

Commented [PW4]: Existence/absence of profits drives entry/exit, as you said when we met!

5. Module 5: Financing - The view from the investor side, what gets funded and why.

The market is often referred to in the singular. Financial markets are, in fact, a complex ecosystem of very different markets that fund very different things based on very different criteria. The module provides a road map to those markets and the analytic tools and frameworks used to make funding decision. The goal will be to provide a basic understanding of how to align policy implementations with the relevant enabling markets. Short term lending markets in the aftermath of Lehmann bankruptcy at the beginning of the financial crisis will be used as the motivating example, but this will also be used to discuss the tech valuation and the funding of innovation.

6. Module 6: Parsing policy problems by tools rather than causes

In this module we look at climate change policy options in detail, but not as a coherent policy problem, but rather as a way of understanding the limits of the policy tools available to address it. The focus is on developing and understanding of how to parse a policy problem into a set of more easily addressable parts by matching specific sub-problems to tools and working to move outcomes in the desired direction by the sum of the interventions rather than finding a “best” approach. In this module special attention will be paid to the political and economic limits of specific policy interventions even when they are well used and how those limits can be overcome by combinations of approaches. This module will be mostly about forward environmental policy to address climate change. It will focus on the nature and limits of the tools available, not on climate science. From a technical perspective this is about how to create an effective portfolio of policies for large complex problems that cannot be addressed through singular solutions.

Readings

Reading are split between applied readings (required) and theory (as helpful). Except as noted in class, the goal of the readings is to provide the student with an understanding of the policy trade-offs, rather than mastery of the specific technical tools. Written versions of the “tool” lectures will also be provided within the modules. Reading marked with * are required. Students are encouraged to at least skim the other readings to find ones that match their own learning styles and backgrounds.

Strongin - Goldman links

*A Survivor’s Guide to Disruption: <https://www.goldmansachs.com/insights/pages/gs-research/survivors-guideto-disruption/report.pdf>

*Who Pays for Bank Regulation: <https://www.goldmansachs.com/insights/public-policy/regulatoryreform/who-pays-for-bank-regulation-pdf.pdf>

*What the Market Pays For: <https://www.goldmansachs.com/insights/pages/what-the-market-pays-for/report.pdf>

Narrowing the Jobs Gap: Overcoming Impediments to Investing in

People: <https://www.goldmansachs.com/insights/public-policy/narrowing-the-jobs-gap-report.pdf>

Commented [PW5]: I suggest organizing these items by Module (1 to 6)

*Ending Too Big to Fail: <https://www.goldmansachs.com/insights/archive/effect-reform-part-5.pdf>

Incentive effects of contingent capital <https://www.uts.edu.au/sites/default/files/Tsyplakov.pdf>

Other readings:

Brown, James R., and Bruce C. Petersen. "Public Entrants, Public Equity Finance and Creative Destruction." *Journal of Banking & Finance* 34.5 (2010): 1077–1088. Web.

Coase, Ronald H., "The Problem of Social Cost: The Citations," 71 *Chicago-Kent Law Review* 809 (1996) It has been accepted for inclusion in Journal Articles by an authorized administrator of Chicago Unbound. For more information, please contact unbound@law.uchicago.edu.

Davis, S.J., Haltiwanger, J. & Schuh, S. Small business and job creation: Dissecting the myth and reassessing the facts *Labor Economics, Employment Policy, and Job Creation*, Lewis C. Solmon and Alec R. Levenson, eds., Westview Press, 1994
["Small Business and Job Creation: Dissecting the Myth and Reassessing the Facts,"](#)

Dempsey, Kyle and Ionescu, Anamaria Felicia, Lending Standards and Borrowing Premia in Unsecured Credit Markets (June 1, 2021). FEDS Working Paper No. 2021-39, Available at SSRN: <https://ssrn.com/abstract=3875095> or <http://dx.doi.org/10.17016/FEDS.2021.039>

Hardin, G. 1968. The tragedy of the commons. *Science* 162(3859): 1243-1248.

Kotlikoff, Laurence and Summers, Lawrence, (1986), Tax Incidence, No 1864, NBER Working Papers, National Bureau of Economic Research, Inc, <https://EconPapers.repec.org/RePEc:nbr:nberwo:1864>.

Lemaire, J. (1984). An Application of Game Theory: Cost Allocation. *ASTIN Bulletin*, 14(1), 61-81. doi:10.1017/S0515036100004815

List, J.A., Pernaudet, J. & Suskind, D.L. Shifting parental beliefs about child development to foster parental investments and improve school readiness outcomes. *Nat Commun* 12, 5765 (2021). <https://doi.org/10.1038/s41467-021-25964-y>

*Stigler, George J.(1961). [The Economics of Information](#). *Journal of Political Economy* 1961 69:3, 213-225 (The material in this article will not be specifically presented, but the core logic will be used through-out the material as it sets the general stopping rule for all forms of market based search, including innovation.)

Petersen, Bruce & Strongin, Steven (1996) Why Are Some Industries More Cyclical Than Others?, *Journal of Business & Economic Statistics*, 14:2, 189-198, DOI: 10.1080/07350015.1996.10524645

Wollmann, Thomas, ["How to Get Away with Merger: Stealth Consolidation and Its Effects on US Healthcare."](#) Working paper, July 2021.

Books – useful to help fill in general background , but none are required

Beer, G. (2009). *Darwin's Plots: Evolutionary Narrative in Darwin, George Eliot and Nineteenth-Century Fiction* (3rd ed.). Cambridge: Cambridge University Press. doi:10.1017/CBO9780511770401

Burrough, Bryan, 1961-. *Barbarians at the Gate : the Fall of RJR Nabisco*. New York :Harper & Row, 1990.

Dixit & Robert S. Pindyck, 1994. "Investment under Uncertainty," Economics Books, Princeton University Press, edition 1, number 5474. (This book requires a strong math background. "Narrowing the Jobs Gap" and "What the Market Pays For" both provide technically less demanding approaches for this material.)

Shubin, N. (2009). *Your inner fish: a journey into the 3.5-billion-year history of the human body*. 1st Vintage Books ed. New York: Vintage Books.