George J. Stigler Center for the Study of the Economy and the State
2015–16 Annual Report
Nobel laureate George J. Stigler founded the Center for the Study of the Economy and the State at the University of Chicago in 1977. From the beginning, it has been a joint enterprise of economists and legal scholars at the University of Chicago Booth School of Business, the Department of Economics, the Law School, and other areas of the university. The center was renamed in Stigler’s memory after his death in 1991.

The George J. Stigler Center for the Study of the Economy and the State is dedicated to understanding the interaction between politics and the economy. To carry out its mission, the Stigler Center embarked on a program of outreach, education, and research. The center publishes a working paper series and promotes the dissemination of research to a wider audience via conferences and lectures.

The George J. Stigler Center is a significant contributor to the continuity and growth of “Chicago Economics,” which is known worldwide for four attributes:

- A view of economic theory as a powerful tool for understanding the world
- A deep appreciation for the role of private markets in promoting human welfare
- An understanding of the legal infrastructure that facilitates market performance
- Careful empirical testing of the predictions of economic theory

Executive Committee

Luigi Zingales
Robert C. McCormack
Distinguished Service Professor of Entrepreneurship and Finance and Charles M. Harper Faculty Fellow

Guy Rolnik
Clinical Associate Professor of Strategic Management
It is with pride that I present to you the 2015–16 Annual Report for the Stigler Center. It was a year of great transformations. After nine years of dedicated service, Robert Topel stepped down as director on July 1, 2015, and I was appointed as his successor.

This change provided an opportunity for a refocusing of the center. Since its founding, the Stigler Center has been dedicated to the study of the effects of political life on economic life and the reciprocal effects of economic life on political life. While still valid, this mission was too broad to characterize our center in an increasingly populated universe of research centers. For this reason, we decided to focus the center on the study of regulatory capture and various forms of subversion of competition by special interest groups. This mission is central to three key elements of George Stigler’s teaching: (1) the appreciation for the role of private markets in promoting human welfare; (2) an understanding of the role that legal infrastructure has on market performance; and (3) the realization that the design of this legal infrastructure is all too often captured by the incumbents to prevent entry and competition rather than to promote human welfare.

With this focus in mind, the activities of the center were developed along three directives. The first is outreach. This includes outreach with our students and local alumni through a vibrant series of 13 lectures (amply described in this report), ranging from Kyle Bass’s trading strategy to fight bad regulation to David Plouffe’s political strategy to overcome the barriers that prevent Uber from entering into many markets. Additionally, we have concentrated on outreach to our broader alumni network and the world through our very own blog, ProMarket. Launched at the beginning of March and edited by Chicago Booth clinical faculty and Stigler Center codirector Guy Rolnik, our blog has instantly gained a relevant space in the economic and public policy blogosphere. One of the goals of this blog is to broaden the impact of our lectures and conferences outside the physical boundaries of the university. To this purpose, we have also created a Stigler Center newsletter. We invite all our friends and associates to register. Finally, we began an initiative to redesign the Stigler Center’s website (research.chicagobooth.edu/Stigler). The new website, launching in early 2016–17, will showcase the research, teaching, and outreach being done at the Stigler Center with an updated and user-friendly layout.

The second directive of our effort has been teaching through course development and case writing. We realized that one of the biggest impediments to the teaching of issues related to regulatory capture, lobbying, and the subversion of competition by special interest groups was the absence of good business cases written on these topics. Consequently, we actively promoted and financed the writing of seven business cases (also amply described in this annual report), four of which have already reached the final draft stage.

The third directive of our effort is the funding of research and academic conferences. With Harvard Business School, we cosponsored a conference on the Crisis of the Theory of the Firm, which will be replicated in Chicago this coming year. We also fund research from top Chicago scholars on issues ranging from the impact of high-speed trading on competition to the effect of fraud on financial advice, and from the crisis of traditional media to the distortions of competition in the mobile industry around the world.

We have an even richer plan of activities for next year. I am excited about the prospects for the Stigler Center and am confident that you will be too. Please join me over the coming year in working to continue to enhance and extend Stigler’s legacy throughout the world. Do not hesitate to contact me if you have any questions or suggestions.

Sincerely yours,

Luigi Zingales
Director, George J. Stigler Center
STIGLER CENTER VISITORS

Anat Admati  
George G. C. Parker Professor of Finance and Economics, Stanford Graduate School of Business

Sumit Agarwal  
Vice-Dean of Research, Low Tuck Kwong Professor at the School of Business, and Professor in the Departments of Economics, Finance, and Real Estate, National University of Singapore

Kyle Bass  
Principal, Hayman Capital Management

Robert Bilott  
Partner, Taft Stettinius & Hollister

Mauro Rodrigues da Cunha  
CEO, AMEC

Jeff Gramm  
Author of Dear Chairman: Boardroom Battles and the Rise of Shareholder Activism and Hedge Fund Advisor

Luba Greenwood  
Vice President of Global Mergers & Acquisitions and Business Development, Roche

Nell Minow  
Vice Chair, ValueEdge Advisors

Randall Morck  
Stephen A. Jarislowsky Distinguished Chair in Finance, University Professor, Alberta School of Business

David Plouffe  
Chief Advisor and Board Member, Uber

Karthik Ramanna  
Associate Professor of Business Administration, Harvard Business School

Jesse Eisinger  
Senior Reporter, ProPublica
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**Bo Rothstein**  
Professor of Government and Public Policy at the Blavatnik School of Government and Professorial Fellow of Nuffield College, Oxford University

**Alan Rusbridger**  
Former Editor-in-Chief, *The Guardian*

**Paola Sapienza**  
Donald C. Clark / HSBC Chair in Consumer Finance and Professor of Finance, Kellogg School of Management, Northwestern University

**Karla Scherer**  
Chair, Karla Scherer Foundation

**Dean Starkman**  
Author of *The Watchdog That Didn’t Bark: The Financial Crisis and the Disappearance of Investigative Journalism* and Former Editor, *Columbia Journalism Review*
IMPACTING THE WORLD
CRISIS IN THE THEORY OF THE FIRM CONFERENCE

November 20–21, 2015 • Chicago

Is Milton Friedman’s dictum that “firms that maximize shareholder value maximize social value” still relevant in a post–Citizens United world? In November 2015, a select group of top economists, legal scholars, political scientists, sociologists, and historians gathered at Harvard Business School for an innovative conference that aimed to answer this very question. If firms are able to alter the rules of the game in their favor, does that mean that Friedman’s belief—that firms can and should benefit society only by focusing on maximizing returns—should be reexamined? The conference (held under Chatham House rules to allow for free discussion) addressed this issue and aimed to resolve the tension between Friedman’s and George Stigler’s worldviews.

For two days, the participants discussed the differences between Friedman’s belief in the general immutability of the rules of the game and Stigler’s theory of regulatory capture, debating whether the underlying assumptions of Friedman’s theory of the firm are still valid at a time when firms are seen not only as economic actors, but as political actors as well.

While the conference did not end in universal consensus, it was characterized by a lively debate, and participants did manage to reach some common agreement. Despite a broad cross section of disciplines, views, and research methods, a majority of speakers and participants generally agreed that, among other things, firms maximize profits by also tweaking the rules of the game to their advantage.

On the question of how to balance the need for firms to pursue every legal opportunity to increase profits with the public need to ensure the integrity of the political process, participants agreed that more empirical research is needed. As a result of the conference, the Stigler Center has begun to develop cases in order to help facilitate the teaching of some of the tensions and questions raised.
The Stigler Center launched a political economy lecture series featuring thought leaders in academia, business, the legal profession, and the media who have experience in the way special interest groups distort markets. In 2015–16, the Stigler Center hosted 13 of these lectures.
How Politics Impacts Financial Markets
October 7, 2015

In 2002, Randall Morck (along with coauthor Bernard Yin Yeung, National University of Singapore) published a paper about what he defined as “the puzzle of the harmonious stock prices”: while in developing countries like China, stocks tend to rise and fall together, in developed markets like the United States, stocks move up and down independently of each other. The poorer and more corrupt a country is, they found, the more harmonious its stock market is.

In his first talk at the Stigler Center, Morck reviewed subsequent papers that tried to explain this phenomenon. He focused on three main explanations. The first is that where the financial system works better, investors are more willing to spend money on getting information on individual firms. The second is that in some countries information is expensive and harder to come by, and therefore investors spend their time getting information that is useful in revaluing many stocks at the same time, instead of stand-alone stocks. The third explanation, offered by Morck himself, is that there are fewer barriers to entry in less corrupt countries.

In his talk, Morck argued that those three possible explanations may all be true at the same time. If a country is less corrupt, and if there’s less stealing by insiders, and if information is more readily available, investors will be more willing to buy into IPOs, and start-up companies with new technologies will be more able to get funding, leading to a more competitive and less harmonious market.

Thin Political Markets
October 7, 2015


Thin political markets, he explained, are esoteric areas of regulation where narrow commercial interests, due to their vast experiential expertise and a lack of public interest, are able to shape the rules of the game. Compared with thicker areas of regulation and policy, where vigorous political competition ensures a lively public debate, thin political markets are characterized by a relative lack of public interest or vibrant dissent. The result, explained Ramanna, is a “quilt of special interest exceptions”: the rules made in these markets often reflect the interests and ideologies of special interests and not necessarily those of the general public.

Ramanna outlined the potential harms of thin political markets and explained how they manifest in areas that remain largely outside the attention of the general public or the press but are crucial to the function of complex market economies—such as bank governance regulation, actuarial standards, auditing standards, insurance standards, and accounting rules for mergers and acquisitions. If ignored, he warned, thin political markets can diminish the determination of critical institutions of capitalism and undermine the legitimacy of the system.
Why Banks Still “Own the Place”
December 2, 2015

“We have too much debt in banking,” said Stanford professor Anat Admati during her talk at the Stigler Center. Seven years after the onset of the financial crisis, she said, the banking industry remains inefficient, dangerous, and distorted because regulations have only been tweaked, even after the crisis. Banks are “getting away with too much inefficient recklessness,” she said.

Admati discussed the basic economics of banking and shared her findings regarding the poor financial health of banking institutions. She explained how confusion and ignorance regarding banking regulation serve to protect the political power of banks and maintain the excessive privileges banks enjoy. The challenge is that there are too few incentives for those involved in the discussion to challenge the system and the narratives that maintain it. “It is difficult to get a regulator to understand something when his future job often depends on him not understanding it. It is difficult to get a politician to understand something when his campaign contribution depends on him not understanding it. It is difficult to get a journalist to understand something when his access to news depends on him not understanding it,” she said, paraphrasing Upton Sinclair.

In her talk, Admati outlined a path to reforming the banking system, centered on the idea that banks should rely less on debt and more on shareholder equity. Equity reduces the likelihood of distress, default, crises, and bailouts, she stated. It also reduces the likelihood of liquidity problems and runs, and reduces excessive risk taking and subsidies for banks deemed too big to fail. Admati characterized the Basel III rules as “inadequate and flawed,” arguing that they allow banks to be too highly indebted and use too little equity. The regulations are based on flawed analyses of the relevant costs and benefits to society of a safer system with much more equity funding, and they actually add distortions and biases in banks’ choices that make the system even more fragile and dangerous, much like the system that brought about the 2007–09 crisis.
The Rise of Executive Impunity
January 5, 2016

In the past few years, the Pulitzer Prize–winning reporter Jesse Eisinger has interviewed dozens of Wall Street executives, defense lawyers, and former prosecutors and regulators in an effort to answer the question that has troubled millions of people around the world since 2008: how come not a single financial sector executive went to jail following the largest financial crisis since the Great Depression?

In his talk, Eisinger presented the findings of his years-long investigation into the development of executive impunity in the US judicial system and claimed that the Department of Justice has become wary of prosecuting corporate executives. “The United States has lost the will and ability to prosecute top corporate executives,” Eisinger said.

Eisinger traced the rise of executive impunity in the United States, from its nascent stages after the successful prosecutions that followed the accounting scandals of the late 1990s and early 2000s, to the current state, in which, he said, prosecutors are bewildered and captured and corporate executives who commit wrongdoing are all but immune.

The turning point, he posited, was the successful prosecution of accounting firm Arthur Andersen, which resulted in Arthur Andersen effectively going out of business and many employees losing their jobs.

Eisinger continued to detail the mechanisms of cultural and intellectual capture that led prosecutors to think twice before charging executives with wrongdoing.
The US Has a Drug Problem
January 26, 2016

Hedge fund manager Kyle Bass has spent the past year and a half waging a legal battle against pharmaceutical firms in an attempt to challenge some of their patents. In his lecture, Bass explained why he set out on a tenuous quest to challenge dozens of drug patents through the little-known process of inter partes review (IPR), and he shared his experience from a year of fighting legal battles against drug manufacturers.

American citizens pay more for prescription drugs than those of most countries in the developed world, with US prices of certain drugs five times higher than they are in countries like Canada or England. According to Bass, this is partly due to the US patent system. A small number of drug companies, he said, are abusing the American drug patent system in order to protect monopoly profits.

Bass explained the reasons he chose to challenge drug patents he deemed unworthy. An initial, simple strategy—to dispute questionable patents and then short the stocks of their manufacturers—had backfired. Bass blamed regulatory capture, claiming pharmaceutical firms influence the decisions of the US Patent and Trademark Office when reviewing his challenges.

Bass also shared his view on the inefficient regulation of US pharmaceuticals, explained how the invalidation of pharmaceutical patents that he claims have been improperly granted can promote competition and innovation, and called on academic institutions and nonprofit organizations to join him and file IPRs of their own against abusive drug patents.
Award-winning journalist and media critic Dean Starkman, author of *The Watchdog That Didn’t Bark: The Financial Crisis and the Disappearance of Investigative Journalism* (Columbia University Press, 2014), offered a comprehensive lecture on the shortcomings of business journalism before and after the 2008 financial crisis. The business press, he claimed, was not equipped to spot the 2008 crisis before it broke and is even less equipped today to spot the next one.

Journalism’s role in a democratic society is to highlight market failures and hold regulators and political leaders to account. But in the years leading up to the 2008 crash, Starkman explained, the business press renounced its obligation to keep the finance industry in check. Instead of accountability, journalists based their reporting on access to insider sources.

In the wake of the financial crisis, many within and outside of the financial press wondered how the media could have missed this, especially given the fact that business journalists uncovered very similar instances of mortgage fraud nearly 20 years before the crash of 2008.

In the years leading up to the crisis, however, financial journalists ignored signs that the entire subprime market was based on widespread fraud and failed to investigate the questionable practices of several financial institutions. A gradual erosion of journalistic tools and skills, Starkman explained, had left journalists unequipped to investigate the systemic fraud that energized the crisis.

Business journalism, said Starkman, became complicit in perpetuating the illusion that the housing and mortgage markets were sound. “There was a bubble all right, and the business press was in it,” he said.

In his talk, Starkman elaborated on the structural and cultural reasons that led to the failure of business journalists to spot the warning signs of the subprime crash, and he explained why he thinks journalism is even less prepared to detect financial crises at present.
Big Pharma: The Business of Innovation and Regulation  
March 3, 2016

Pharmaceutical executive Luba Greenwood shared her extensive experience providing legal and strategic counseling for pharmaceutical and biotechnology firms in areas like innovation, regulation, intellectual property, mergers and acquisitions, and litigation. In her talk, Greenwood explored the roles that incentives, regulators, lobbyists, and the US patent system play in driving the business model of the American pharmaceutical industry. She explained the crucial roles lobbying and marketing, especially direct-to-consumer advertising and sales representatives, play in determining prices and decisions made by physicians. Greenwood also addressed schemes like lifecycle management and pay-for-delay and their effect on drug prices.

Climate Change: Why Journalism Failed  
March 15, 2016

Alan Rusbridger edited The Guardian for 20 years and, in that time, managed to turn the publication from a small British newspaper into a leading global voice. During his editorship, The Guardian broke a number of stories of global significance, among them the Edward Snowden revelations (for which it won the Pulitzer Prize), the HSBC tax avoidance scandal, and the illegal activities that eventually led to the closing of the British tabloid News of the World. It also led an innovative digital approach that made it one of the top news outlets in the English-speaking world.

In his talk at the Stigler Center, Rusbridger discussed what he saw as the failure of journalism to respond to one of the most pressing issues of our time: its inability to adequately portray the true significance of climate change. He also explained why he spent the last months of his term as editor-in-chief running an unusual advocacy campaign meant to raise public awareness of climate change.

Rusbridger discussed some of the biggest stories of his editorship, like the News of the World scandal. He explained why The Guardian’s unique ownership structure allowed it to maintain its integrity and journalistic values even in the face of immense pressures, and he spoke of the challenges of pursuing tough stories that are in the public interest in an age of financial uncertainty.
Robert Bilott, a partner at the Taft Stettinius & Hollister law firm, addressed the difficulties in fighting against emissions of toxic chemicals. Bilott’s firsthand experience comes from challenging DuPont’s chemical contamination of drinking water near the company’s plant in West Virginia. Unlike plaintiff lawyers, who usually move on to the next case after they reached a hefty settlement, Bilott went on to what is now almost two decades of attempts to alert regulators and continue litigating in ways that will limit the health and environmental effects of the chemical in question.

In the process, Bilott exposed a decades-long history of chemical contamination and the mechanisms that allow it to go unregulated. He also learned how difficult it is to bring a meaningful change, due to various legal, political, scientific, and social factors. Bilott mentioned, for example, how state-level regulators are usually reluctant to go against the biggest employer of their constituencies; how federal regulators tend to play it too safe and cozy, avoiding conflict with the better-informed and resourced industry; and how concentrated interests are much better built for lengthy, complex, and costly legal battles.
How Scandinavian Countries Became Non-Corrupt
April 11, 2016

“Democracy is not a safe cure against corruption,” Bo Rothstein said during his talk. The Swedish political scientist, a professor of government and public policy at the Blavatnik School of Government in Oxford, England, has spent decades studying quality of government. Using the historical experience of Sweden and Denmark as an example, Rothstein outlined a unique approach to eradicating systemic corruption.

Much of Rothstein’s work represents a departure from the dominant stream in political science, which focuses on democratization as the main recipe for promoting prosperity. “There is zero correlation between democracy and human well-being,” Rothstein said, adding: “Democracy is a great thing, but it has to be motivated by other things than delivering well-being, because it doesn’t. What delivers human well-being is if you can get reasonable state capacity, control of corruption, and government effectiveness.”

The focus on democracy as the sole recipe for development, he said, has resulted in a “massive policy failure” by the international and development community.

The cure against corruption, Rothstein argued, is not through incremental changes, but by developing strong institutions through a “Big Bang” of social and political reforms. “Dysfunctional public institutions are the root cause of human misery,” said Rothstein, who continued to advocate an approach to fighting corruption that is not in line with the dominant principal-agent theory, which, according to Rothstein, represents “a quite serious misunderstanding of the problem.”

Instead, Rothstein supported an approach based on the theory of collective action. “If corruption was a question of changing incentives, we would have fixed the problem long ago,” he said. The problem with the principal-agent approach to corruption, he said, is that “the agent that is going to change the incentives has no incentives to change the incentives. The theory builds on an agent that is not supposed to exist, according to the theory.”

The collective action approach to corruption, argued Rothstein, can be best exemplified by Sweden and Denmark. Both countries suffered from widespread corruption and cronyism in the early 19th century but succeeded in eradicating corruption within a period of 25 years through a “Big Bang”-type transformation of their political culture away from particularism, personal rule, and partial exercise of power toward impersonal rule and impartiality in the exercise of power. “Corruption should be seen as a self-reinforcing equilibrium,” said Rothstein. Instead of focusing on rational utility maximization, the collective action approach relies on reciprocity. “If you live in a society where the perception is that most agents are engaged in this dysfunctional behavior, it makes little sense to be the only honest person in a rotten game,” he said. “People are willing to do the right thing, but only if they are convinced that most other agents in their situation are willing to do the right thing.”
The panel, moderated by Guy Rolnik, clinical associate professor of strategic management at Chicago Booth, explored the different perspectives of Swedish political scientist Bo Rothstein (Oxford University) with those of two economists, Chicago Booth’s Luigi Zingales and University of Chicago’s Casey Mulligan, on issues like competition, the size of government, and corruption. Together, they debated what makes countries successful, how to best define corruption, and what is the best model for the US healthcare system.

When asked to name the single biggest problem facing the US and world economies, each panel participant voiced a different opinion. “To me, the biggest problem is vested interests distorting competition,” said Zingales. Mulligan spoke of regulatory overreach, and Rothstein chose corruption. When asked for his definition of corruption, Rothstein answered that it is a lack of impartiality on the part of public officials.

The participants spoke of the financial crisis and talked about the part regulation and big government played in the success of the Swedish economy. “This conflict between market or state is not productive,” said Rothstein. “You can have very small states that are extremely detrimental to anything that spells market, and you can have big states like Denmark, where large sections of social services are basically taken out of the market, but they are extremely market-friendly.”

When it came to the subject of what constitutes a public good, Rothstein and Mulligan represented two opposite extremes. On the subject of American healthcare, too, the panel remained divided. “The problems in healthcare are not primarily asymmetric information, but barriers to entry leading to high cost and low value to the customer,” said Mulligan. Rothstein, on the other hand, thought the challenges facing American healthcare showed the “problem with a market-arranged healthcare system.”
Work on Demand—Serving Chicago’s Underserved
April 19, 2016

“We’ve been called a disruptive company. I think it would be more accurate to call us an additive company,” said David Plouffe during a fireside chat at the Stigler Center on the challenges posed by wage stagnation and the opportunities brought forth by “sharing economy” apps like Uber.

Plouffe, a former political strategist who managed Barack Obama’s transformative presidential campaigns and is currently chief advisor and board member at Uber, talked about Uber’s remarkable success in transforming the transportation business, its regulatory challenges, and the company’s operation in Chicago. “Every month it’s more resembling the city. Our drivers are middle-income people, women, retirees, stay-at-home parents. No doubt we’re a great bridge—if you lose your job, if you receive a bill you did not expect, you can use our platform—but a lot of people use this aspirationally too,” said Plouffe.

Speaking about Uber’s tumultuous regulatory history, Plouffe said: “We are firmly a tech company, but we do get embroiled in regulatory discussions.” Sounding an optimistic note, Plouffe argued that, on the whole, despite some resistance in southern European countries, Uber will end up overcoming many of its current regulatory challenges. “Here in the US, for the most part, the debate has moved beyond the core regulatory discussion to next-generation issues like labor. Most of the world has decided that ride sharing is here to stay. More people understand there are some public benefits to that, and the debate now focuses on what is the best way to handle that.”

Plouffe continued to talk about Uber as an “augmentation to traditional work,” its battles with the taxi industry, the company’s users’ unique form of activism, and the benefits of flexible work. “Our conversations with regulators are not should Uber exist or not—we have competitors in almost every market we’re in—but what is the right way to do it,” he said.
Corporate Governance in an Era of Shareholder Activism Panel
May 3, 2016

With the recent surge of shareholder activism and the rising demand for more accountability from boards, a panel hosted by the Stigler Center discussed the positive role shareholder activists can play in corporate governance. The panel featured Karla Scherer, Nell Minow, Paola Sapienza, and Jeff Gramm, with each member drawing from their own personal and professional experience to highlight some of the most pressing issues related to corporate governance and shareholders’ rights, from the dependency of boards on CEOs to the difficulties of minority board members. Together, they debated the rise of CEO pay, the role of dissenting directors, the treatment of female board members, and the proper “rules of engagement” for directors who want to engage with shareholders and activists.
FACULTY LUNCH SEMINARS

The Stigler Center fosters discussion among faculty by inviting scholars conducting high-quality research in their fields to speak at seminars for Booth faculty and PhD students. In 2015–16, the Stigler Center held four of these seminars.

Shareholder Rights and Regulatory Framework in Brazil: Lessons from the Frontline
October 6, 2015

Mauro Cunha, CEO of AMEC (Association of Capital Market Investors), gave a lecture on the failures of corporate governance institutions in Brazilian financial markets. The development of capital markets, said Cunha, depends on the respect, protection, and improvement of minority shareholders’ rights. He discussed the way the investors and institutions that he represents are fighting for reforms and fighting for protection of minority shareholders’ rights. Cunha also spoke at a Latin American Business Group event sponsored by the Stigler Center on October 12, 2015.

MAURO RODRIGUES DA CUNHA
CEO, AMEC
In his Stigler Center lunch seminar, University of Alberta School of Business professor Randall Morck surveyed the history of the large pyramidal groups that dominated many American industries in the 1920s and 1930s. While public firms often belong to large, powerful business groups in many countries, American-listed firms today are largely freestanding. This, Morck argued, was a direct result of concerted government actions in the 1930s and 1940s that led to the breakup of the few large business groups that dominated the American economy until then.

Following concerns that they had grown too politically powerful and were abusing their monopoly powers to curb competition, the American government enacted a series of policies that were overtly directed to break up the big business groups. These policies included the Public Utility Holding Company Act of 1935, rising intercorporate dividend taxation, and enhanced investor protections, along with strong antitrust enforcement and banking reforms. These reforms severely limited the power of controlling owners and, by the 1950s, had led to the dissolution of the big business groups, creating an ecosystem of freestanding firms that has since remained intact.

Morck’s talk, based on his 2015 eponymous paper (cowritten with Eugene Kandel, Konstantin Kosenko, and Yishay Yafeh), outlined a potential road map for industrialized countries that wish to diminish the power of large pyramidal business groups by implementing a multi-front agenda that, if backed by a supportive political climate, could create a much more competitive environment.
What’s Wrong with Banking and What Academics Can Do About It
December 3, 2015

In a talk with Chicago Booth faculty, Anat Admati reviewed the fragilities of the current banking system and how it became dangerously complicated, a “Rube Goldberg machine,” as financial institutions sought to hide risks from regulators and investors. The financial crisis, she argued, was not an unpreventable natural disaster, akin to an earthquake, but the result of a natural addiction to borrowing (and risk) that comes from heavy borrowing and characterizes distressed or insolvent corporations, and the failure of regulation. The easy access to funding that banks enjoy, she said—for example, because depositors are particularly passive creditors—provides clear incentives to endanger and prevents banks from internalizing the collateral impact of their actions. When markets fail, regulations become essential.

In a spirited debate with faculty members, Admati discussed the role academics can play in solving market inefficiencies. Academics, she argued, have the power to reverse engineer models that justify flawed claims, but instead they should examine reality, theoretically and empirically, so we can clear confusion and provide useful policy advice.

Admati also spoke at a Chicago Women in Business event on December 2, 2015.

Insider Trading by Public Servants: Evidence from the Real Estate Transactions in a Developed Country
April 28, 2016

Sumit Agarwal presented a new paper, cowritten with Amit Seru (Chicago Booth), Tomasz Piskorski (Columbia Business School), Tien Foo Sing (National University of Singapore), and Jian Zhang (National University of Singapore), on insider trading by public servants. The paper examines real estate transactions in Singapore, a country that ranks very low on corruption indices. Agarwal discussed data analysis showing evidence of insider trading in the housing market. The paper uses announcements of new railway construction in Singapore to analyze insider trading by public officials. They find that civil servants, who would have early access to the information, aggressively purchased houses located near the new railway stations in the year prior to the announcement of new railway construction. These insider purchases were higher for mid-level civil servants and those closer to the information source. Agarwal also discussed the implications these results have for social welfare.
In March, the Stigler Center launched its new blog, ProMarket, with the aim of promoting discussion about an issue that, despite its enormous importance and relevancy to the current political and societal climate, receives little attention in the media and in academia: the subversion of competition by special interests.

While most economists agree that competition is the essential ingredient that makes a market economy work and benefits everyone, the general public remains diffuse, unaware, and unmobilized to defend competitive markets.

The goal of the blog (located at Promarket.org) is to educate the public about the many ways competition can be subverted. In the finest University of Chicago tradition, we intend to do so with data and the rigor of academic work.

In its first months of activity, ProMarket has hosted original research done by the Stigler Center (such as the Campaign Financing Capture Index, which examines the influence of special interests on presidential candidates in the 2016 elections) and Chicago Booth faculty, as well as commentary, analysis, and reviews of new academic studies. By gathering information on the nature and cost of subversion of competition, and by distributing this information among the public at large, we believe we can create demand for competitive capitalism and make the market system work better.

In order to enrich the intellectual debate, we have launched a series of “mini-papers” that are relevant to the public debate. While academic papers are supported by rigorous economic analysis and take years to develop, and opinion pieces tend to lack the same kind of rigor, ProMarket has tried to bridge the gap by producing these mini-papers—short studies with the methodology and the attention to data typical of the best academic papers, but without the extension and depth appropriate for an academic publication. By doing so, we hope to deepen the policy discussion and bring academic research to the forefront of the public policy debate.
The 2016 presidential election is widely expected to be the most expensive election in US history. While the candidates differ widely in their policy recommendations for the US economy, they also differ in the sources, distribution, and size of their political contributions.

The Campaign Financing Capture Index analyzes the distribution of political contributions to presidential candidates and takes into account individual contributions and contributions made to the campaign committees, as well as contributions made to PACs, super PACs, and joint fund-raising committees that support each candidate.

The project aims to track the attempts of large political contributors to affect public policy by focusing on the fraction of total funds raised from large donors. We believe that campaign donations can be a mere expression of political preference, but, when they start to exceed $5,000, contributions are more likely aimed at altering policy in favor of the donor’s interest than promoting the public interest. The more a politician relies on large contributions, the less he or she is able or willing to lead reforms and change the rules of the game in markets where powerful special interest groups enjoy the status quo. When the percentage of funds raised from large donors is significant, as it has been in recent years, this problem becomes acute.

Based on data collected from the Federal Election Commission website, the index aims to provide a measure of candidates’ potential dependence on special interest groups. The Stigler Center will publish a concentration and distribution analysis every three months until the presidential elections.
MINI-PAPER SERIES

In the intellectual debate, there is a gap between academic papers and policy opinions, even those written by economists. Academic papers are supported by the most rigorous economic analysis—so rigorous that it takes years to develop and even longer to get published. One of the goals of the ProMarket blog is to bridge this gap by producing mini-papers relevant to the public debate, with the methodology and the attention to data typical of the best academic papers, but without the depth and breadth characteristic of an academic publication.

Are Newspapers Captured by Banks?
Evidence from Italy
May 12, 2016

The mini-paper “Are Newspapers Captured by Banks? Evidence from Italy” compares the treatment by Italian newspapers of news directly affecting the banking sector. In reporting about a law that was costly to the banking sector, Italian newspapers were more negative than international ones. The opposite was true in reporting about the creation of a fund meant to rescue some banks. More interesting, the average spin of the articles was correlated with the leverage of the newspaper—the more in debt a newspaper was, the more likely it was spinning the news in the direction favorable to banks. While the sample size is too small to draw any strong conclusions, the evidence suggests that when the media are highly indebted, banks can affect the spin of the news they care about.

LUIGI ZINGALES

Robert C. McCormack
Distinguished Service Professor of Entrepreneurship and Finance
and Charles M. Harper Faculty Fellow, Chicago Booth
TEACHING
As part of its new focus on regulatory capture and distortions created by special interest groups, the Stigler Center expanded its outreach to teaching in MBA programs. In 2015–16, the Stigler Center created a new course on how media influences business, taught by Stigler Center codirector Guy Rolnik. The center also launched a case study series to enhance teaching on issues related to regulatory capture, lobbying, and the subversion of competition by special interest groups.

Reputation, Regulation, and Communications—How Media Influences Business

All businesses face multiple stakeholders: shareholders, customers, employees, activists, NGOs, politicians, and regulators. Businesses interact with all these stakeholders mainly through the media. The media shape their reputation vis-à-vis their stakeholders, the way they are regulated, their costs, and their opportunities. This course explains how media influences companies and industries and how companies can affect this interaction. We start by analyzing the economics of media companies and how they work on the commercial and editorial sides. We continue by going deeper into the interplay among media, regulators, and companies, and we focus in depth on media and the financial markets, crisis communication management, and the role of the internet and social networks. Students will participate in a simulation on the influence of the media on the stakeholders of a company, including shareholders and potential investors, customers, employees, activists, NGOs, politicians, and regulators. The simulation gives the students the opportunity to put into practice some of the skills and strategies that they will have learned during the course.
In 2015–16, the Stigler Center began work on seven new case studies, four of which have already reached the final draft stage.

**Cumplo**

**How regulation is used to prevent entry, especially in developing countries**

Cumplo is a peer-to-peer lender that broke into the oligopolistic world of consumer financing in Chile. The incumbents pressured the regulator to criminally indict Cumplo for violation of the banking law. The founders were able to fend off this attack by promoting their image in the local and international press. Cumplo is now poised to become the main peer-to-peer lending platform in Latin America.

**Suitable courses:** entrepreneurship, strategy, media, political economy.

**Bigger picture:** This case illustrates how new business models, which challenge powerful incumbent industries, need to adopt a media strategy parallel to their business strategy.

**Mediapart**

**Bucking the trend in the media industry**

Started by former *Le Monde* editor Edwy Plenel, Mediapart seemingly runs against all the conventional wisdoms about how media should work in 2016. Most notably, it manages to break even and profit solely on subscribers’ revenues, it gets the French people to pay for online content, and it produces long-form investigative journalism and not just clickbait. What are the drivers of this apparent success story? Are they sustainable? What are the challenges they still have to face?

**Suitable courses:** entrepreneurship, strategy, media.

**Bigger picture:** This case is both an example of successful entrepreneurship in a very difficult industry and an alternative business model for investigative journalism.
When MBA students discuss Disney, it is usually within contexts such as vertical integration, creativity, and the like. But a large part of Disney’s revenues depend on constantly extending the copyright protections it enjoys. This is why every time the copyright over Mickey Mouse is about to expire, Disney lobbies heavily—and successfully—to change federal laws and extend (retroactively!) the protection it enjoys. The Mickey Mouse case illustrates how policies meant to incentivize innovation can be co-opted to stifle it.

Suitable courses: The case appeals to courses on business strategy, the entertainment industry, intellectual property, as well as regulation and political economy.

Bigger picture: This example raises issues of intellectual property protection. How much is too much from a societal perspective? And who gets to dictate the answers?

The Pharmaceutical Challenge
Can the profit motive solve regulatory problems?

The pharmaceutical industry’s business model is predicated not just on R&D and a quality pipeline, but also on its marketing, legal, and regulatory departments prolonging intellectual property privileges. We examine the story of hedge fund activist Kyle Bass, who thought he could make money by betting against bad patents. Based on merit alone, Bass seemed to have a case: the pharmaceutical companies he targeted were indeed enjoying too much protection without producing innovation in healthcare. In other words, Bass targeted companies that were engaging in “lifecycle management” meant to prevent reaching the “patent cliff”—practices that are good for the company but bad for society at large. But as Bass found out, the patent system is not necessarily merit-based. It is extremely tough to bet against big pharma’s ability to affect the rules of the game.

Suitable courses: healthcare and intellectual-property related courses, as well as regulation and political economy.

Bigger picture: This case fleshes out how companies compete over which ones tweak the rules of the game better rather than which provide better products/services. These dynamics and their normative implications are more pronounced in the pharmaceutical industry, where the perceived purpose should be making patients’ lives better and healthier.

Disney
How much of The Walt Disney Company’s business model is riding on its ability to change US copyright laws?

When MBA students discuss Disney, it is usually within contexts such as vertical integration, creativity, and the like. But a large part of Disney’s revenues depend on constantly extending the copyright protections it enjoys. This is why every time that the copyright over Mickey Mouse is about to expire, Disney lobbies heavily—and successfully—to change federal laws and extend (retroactively!) the protection it enjoys. The Mickey Mouse case illustrates how policies meant to incentivize innovation can be co-opted to stifle it.
TheMarker
Can a newspaper be a tribune of the people? Should it?

The Israel-based business magazine–turned–newspaper TheMarker adopted an agenda of fighting against economic and political concentration. The paper’s active, constant campaign led to unprecedented socioeconomic protests, which were later translated into unprecedented legislation meant to reduce economic concentration. But at what cost to the media company? And at what benefit to society? TheMarker and its “parent” publication, Haaretz, suffered from an advertising boycott as a result of their activism. And the real impact of the concentration reform remains to be seen: the reform may die slowly in its implementation stage without actually improving the economy. The change may be short-lived and simply a congruence of events rather than a seismic shift.

Suitable courses: primarily media-related courses, but also macroeconomics, antitrust, political economy, regulation.

Bigger picture: The case spotlights two types of big-picture insights. One set of insights deals with what shapes regulation (public opinion and perception); the second deals with reputational concerns at the media level: can a media outlet create, maintain, and profit from having a reputation for representing the dispersed public?

Piraeus
How banking regulators benefit banks

In the middle of the Cyprus solvency crisis, the Greek bank Piraeus received a large windfall in the form of Greek branches of a Cypriot bank. A tour behind the scenes reveals just how much thought and resources were invested in assuring that the public would finance this gift to Piraeus: advertising, charitable contributions, and personal connections.

Suitable courses: finance/banking, macroeconomics, media.

Bigger picture: This case study fleshes out EU politics and general “soft capture” dynamics: advertising as lobbying, corporate philanthropy as co-optation, and so forth.

Clarin
How powerful is too powerful when it comes to media?

The Argentinian media company Clarin is extremely powerful. Traditionally, Clarin served as the clearinghouse and facilitator of rent-seeking activities in Argentina. But once the new political regime executed a concerted effort to capture the media, the all-powerful Clarin became a valuable check on government power.

Suitable courses: media, policy, macroeconomics.

Bigger picture: The case emphasizes the political role of the media and how it is connected to the business model of media groups.
Together with coauthor Mark Egan (University of Chicago), Amit Seru and Gregor Matvos construct a novel database containing the universe of financial advisers in the United States from 2005 to 2015, representing approximately 10 percent of employment of the finance and insurance sector. Roughly 7 percent of advisers have misconduct records. Prior offenders are five times as likely to engage in new misconduct as the average financial adviser. Firms discipline misconduct: approximately half of financial advisers lose their jobs after misconduct. The labor market partially undoes firm-level discipline: of these advisers, 44 percent are reemployed in the financial services industry within a year. Reemployment is not costless. Following misconduct, advisers face longer unemployment spells and move to less reputable firms, with a 10 percent reduction in compensation. Additionally, firms that hire these advisers also have higher rates of prior misconduct themselves. The professors find similar results for advisers of dissolved firms, in which all advisers are forced to find new employment independent of past misconduct or performance. Firms that persistently engage in misconduct coexist with firms that have clean records. They show that differences in consumer sophistication may be partially responsible for this phenomenon: misconduct is concentrated in firms with retail customers and in counties with low education, elderly populations, and high incomes. Their findings suggest that some firms “specialize” in misconduct and cater to unsophisticated consumers, while others use their reputation to attract sophisticated consumers.
INNOVATIVE RESEARCH

The George J. Stigler Center for the Study of the Economy and the State

ERIC BUDISH
Professor of Economics and Richard N. Rosett and David G. Booth Faculty Fellow, Chicago Booth

The High-Frequency Trading Arms Race: Frequent Batch Auctions as a Market Design Response

Eric Budish’s paper, cowritten with Peter Cramton (University of Maryland) and John Shim (Chicago Booth), on the high-frequency trading (HFT) arms race, which argues that many of the negative aspects of HFT are symptoms of flawed market design, was published as the lead article in the November 2015 issue of the Quarterly Journal of Economics. The market design proposed in that paper, frequent batch auctions, continues to generate significant interest from industry and regulators.

Stock Exchange Competition: Theory, Evidence, and an Application to Market Design Innovation

Budish has followed up on his high-frequency trading research with a new study on competition between stock exchanges, together with John Shim and Robin Lee, an expert on platform competition. One specific question that motivates this research is whether either an incumbent exchange or a de novo entrant could successfully adopt frequent batch auctions.

Do Firms Underinvest in Long-Term Research? Evidence from Cancer Clinical Trials

Over the past year, Budish has focused his research on patent design and innovation incentives, which is a joint research agenda with Ben Roin, a patent scholar, and Heidi Williams, a health and innovation economist. Their first paper together, which shows that the patent system inadvertently underincentivizes long-horizon R&D, was published in the American Economic Review and recently received the Arrow Award for best paper in the area of health economics. They are working on a new project on the so-called “new uses” problem—i.e., incentives to invest in discovering new uses for existing drugs.

Highlights from the past year include presenting at high-profile conferences organized by the US Treasury and the UK Financial Conduct Authority, and engaging in the regulatory debate in the United States concerning stock exchange regulation and Treasury market regulation via a series of formal comment letters.
Political Determinants of Competition in the Mobile Sector

Do political factors affect the degree of product market competition? To explore this question, Zingales, together with Mara Faccio (Purdue University), focuses on the mobile telecommunications sector. After controlling for differences in market size, they find that the degree of competition is higher in more democratic countries, especially in Scandinavian ones, and lower when the incumbent phone operators have more political connections. They also find some direct evidence of how political power affects the degree of competition through spectrum auctions and antitrust enforcement (or lack thereof). Not surprisingly, in the mobile sector, more competition leads to lower prices. Yet there is no evidence that it leads to lower quality or fewer investments; if anything, it is the other way around. Finally, they estimate the potential welfare transfer of reduced competition. US consumers would gain $72 billion a year if US prices were in line with Danish ones and $32 billion if they were in line with German ones.

The Value of Social Networks in Bank Lending

Zingales and coauthor Luigi Guiso (Einaudi Institute for Economics and Finance) link a directory of the members of a social club in Italy to information from the credit register to study the effect of social networks on bank lending. They find that a bank whose officers are part of the same social network as officers of a firm has two and a half times the probability of extending a line of credit to the firm than a random bank. As a new bank enters the club, chances increase that a new relation with a firm in the club is set up; as the bank exits the club, existing relations are discontinued. The effect of club membership is stronger for firms that are more likely to suffer from imperfections in credit markets, either because they are too small or because they are illiquid. Effects of membership are additive, and the total amount of credit a firm gets is larger the higher the number of banks with representatives in the same club. This analysis indicates that social interactions facilitate market relations. However, the establishment of social relationships is itself subject to frictions, which may have repercussions on the functioning of the market for credit.
The media can play a crucial role in curbing crony capitalism by gathering information on the nature and cost of cronyism and by distributing this information among the public at large. This investigative activity has some of the characteristics of a public good, characteristics that have been exacerbated by the ICT revolution. As a result, the traditional newspaper business model is dead. Rolnik and Zingales explore which new media business models can potentially substitute for the dying role of traditional media. They also analyze what role academia can play in gathering information on the nature and cost of cronyism and in distributing this information.
George J. Stigler joined the faculty of the University of Chicago Booth School of Business and the Department of Economics in 1958. His efforts helped make an extraordinarily fruitful cooperative research enterprise among the university’s Department of Economics, Law School, and Booth. Together with the arrival of Merton Miller in 1960, Stigler is widely recognized as having established Chicago Booth as a world leader in academic research.

Stigler was one of the great economists of the 20th century. He made seminal contributions to the economic theory of information and oligopoly and to the economic analysis of government regulation and the public sector. Stigler received the profession’s highest honors, including the presidency of the American Economic Association and the Nobel Memorial Prize in Economic Sciences. His 1982 Nobel Prize was the first awarded to an economist whose primary appointment was in a business school.