Introductory Remarks by Professor Walter Mattli*

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The Need to Invigorate Democracy to Secure Financial Reforms and Save the Economy

I would like to step away from finance for a minute and raise the following general question: what lessons can the history of regulation teach us about the conditions under which regulatory reform is more likely to succeed than not. Reform, across all sectors of the economy, is almost always reactive – not proactive, that is, it responds to a big crisis, scandal, disaster, or accident. There are plenty of cases of attempted overhaul of dysfunctional regulatory regimes. However, three historical facts stand out:

First, effective or successful regulatory change is relatively rare. There are many more cases of failed reform than success.

Second, even successful cases tend to be highly protracted affairs, sometimes taking decades. Part of the reason is that the process of reform has multiple stages, each of which may take a long time: First, the *Agenda*-setting stage; then the *Negotiation* stage during which legislation is produced; then comes the *Implementation* stage resulting in detailed rules; then the *Monitoring* stage, that is, the putting in place of an effective system of monitoring compliance with the new rules; and, finally, the *Enforcement* stage – without an effective enforcement system, reforms will not succeed. I recently had a meeting with a CFTC Commissioner and asked him: 'What resources do you have to systematically enforce your new rules on derivatives?' He replied: 'No significant resources at all.' This may be a huge problem for achieving successful reform.

The third historical fact is trivially true: regulatory change produces winners and losers, and potential losers will fight at each of the five stages to try to slow down or kill the process of reform. And sometimes, the potential losers are very powerful economically – think of the tobacco industry, the pharmaceutical, chemical, car, and steel industries at various moments in history.

Now, we all know that the financial sector has grown by leaps and bounds over the last three decades, by any measure, and today is a dominant sector of the modern economy. There is nothing wrong with economic dominance; it may simply be the result of a very successful business model. But economic dominance must not be allowed to become politically PRE-

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dominant. Historically, where an industry has become politically predominant, reforms have failed.

So what needs to be done to avoid such an outcome, in general, and, specifically, in the context of financial reform? My answer, based again on an analysis of the historical record, is actually very simple: Failure can be avoided by invigorating two fundamental principles of democracy: First, robust *institutional* checks and balances broadly conceived; and, second, solid *political or societal* checks and balances. Let me take just two minutes to elaborate:

Institutional checks and balances comprise transparency in rule-making, proper due process, accountability and oversight, and perhaps most critically, fair and equal access as early as the agenda-setting stage for *all* major stake-holders in society. I was struck by a recent comment by Richard Raeburn, chairman of the European Association of Corporate Treasurers. He complained about the European Commission being 'over-lobbied' by the financial sector so much so that fatigued drafters of regulation close their doors on other representatives. He went on to say: "We…require a form of *affirmative action* on the part of the European Commission to ensure…that access is allowed even if the requests…are later than those made by the better funded financial sector lobby." Now, if Raeburn and his members have access problems, just imagine what the difficulties must be for consumer groups and other little guys. Huge. Any solutions? Well, yes, there are solutions; and, in fact very interesting solutions developed, for example, in insurance regulation in the United States, including so-called proxy advocacy, trilateralism, and other consumer empowerment schemes.

Finally, political or societal checks and balances: History shows that the chance of successful reform grows with the emergence of pro-change alliances of so-called 'strange bedfellows'. These alliances typically comprise consumer groups and other little guys, and critically, big corporations or those parts of a targeted industry what actually welcome new regulation because it opens new business opportunities. Think of the recent success of US consumer groups allied with big corporations such as WalMart and Home Depot in their fight with Visa, MasterCard, and credit card banks over swipe fees. Or think of companies such as Bloomberg and Tradeweb, pushing important parts of derivatives regulation with others, because it will enable them to enter lucrative new businesses.

The point is: the financial industry is not homogenous; there are sometimes deep divisions, important differences in preferences over proposed rules. So one recommendation is for public officials or in fact private-sector entrepreneurs to establish and support matchmaking schemes and mechanisms that facilitate the formation of alliances of strange bedfellows, thereby enabling a much more balanced interest representation in rule-making.

A concluding note: Democracy cannot be taken for granted – it must evolve to deal with new challenges and fit new realities on the ground to remain functional and effective. And nowhere is this more pressing, in my view, than in the context of financial regulatory reform.