

Discussion of “Are There Empirical Foundations for the Iron Law of Financial Regulation?” by Roberta Romano

Francesco Trebbi

UC Berkeley, NBER, CEPR

Hoover Institution, February 15th, 2024

Discussion of “Are There Empirical Foundations for the Iron Law of Financial Regulation?” by Roberta Romano

Francesco Trebbi

UC Berkeley, NBER, CEPR

Hoover Institution, February 15th, 2024

Overview

- I enjoyed the paper. Thank you for the stimulating reading
- Merges two research areas of great interest: **Financial Crises & Regulation**
- Author sets a high bar: Establishing a conjoint set of strong empirical regularities, **An Iron Law of Financial Regulation**
- *“Following financial crises, Congress invariably enacts legislation, and that legislation increases financial regulation, resulting in a regulatory ratchet in which new statutes are layered on top of existing laws, and new regulations are grafted onto existing ones, creating an increasingly complex and opaque regulatory regime that is likely to contain at least some inapt provisions.”* (p.1)

Overview (cont.d)

- Note that **each of these highlighted elements requires rigorous empirical validation**
- The quantitative evidence presented **moves in the right direction**. I would not call it conclusive.
- To be precise: it does not meet the criteria that we'd apply at *Econometrica*. (But we want an Iron Law, right?):
 - e.g., to prove "***inapt provisions***" requires a fairly difficult exercise in quantitatively assessing the "***apt***" counterfactual rule, which is not in the paper
 - e.g. unfalsified elements. **The shock of a financial crisis is not necessarily an unmitigated mess**. Different regulatory responses may be due to learning following **strong informative signals that demand complex answers**. The paper leaves this out

Outline of Discussion

Two parts:

- ① **Regulation-follows-crisis hypothesis.** Yes, but hard to make a general case out of a very limited time series/bivariate OLS
- ② **Post-crisis regulation more stringent/complex than “normal times” hypothesis.** Issues with textual measures of stringency. Welfare assessment is speculative

What is a Crisis (in the Time Series)?

According to BFFS Global Crises Data Project at HBS, (see Reinhart and Rogoff, 2009)

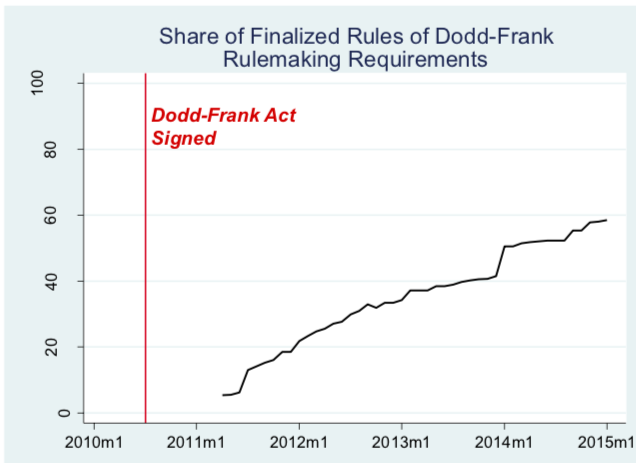
- ① **Financial** crisis incorporates a family of events: **Banking** Crises; **Currency** Crises; **Inflation** Crises; **Systemic** Crises
- ② Author focuses on banking crises alone. 3 episodes in the period 1915-2016, same as RR. See Appendix.
- ③ But why this specific selection? **There are 12 different crises episodes in 1915-2016**
- ④ Shouldn't an Iron Law extend to other cases? Why wouldn't we expect a similar congressional response? (e.g. Inflation Reduction Act of 2022)
- ⑤ Cannot be just tractability. **Loss of generality** + certain crises overlap & the legislative/regulatory response may be affected by **interaction**

Crisis As Usual?

These **crises are quite prolonged**. RR 3 banking crises cover 12 of the 102 years between 1915-2016

- ① But broadly defined financial crisis years cover **32 of the 102 years** between 1915-2016, in 12 separate episodes including currency & inflation crises.
- ② **1 year out 3 is in some sort of crisis!**
- ③ This really complicates event study timing. To what should the Iron Law be timed?
- ④ To add to this, regulatory response follows a slow process of rulemaking

Rulemaking Dodd-Frank Act of 2010



Note: Dynamic accumulation makes the use of simple event study evidence difficult to support.

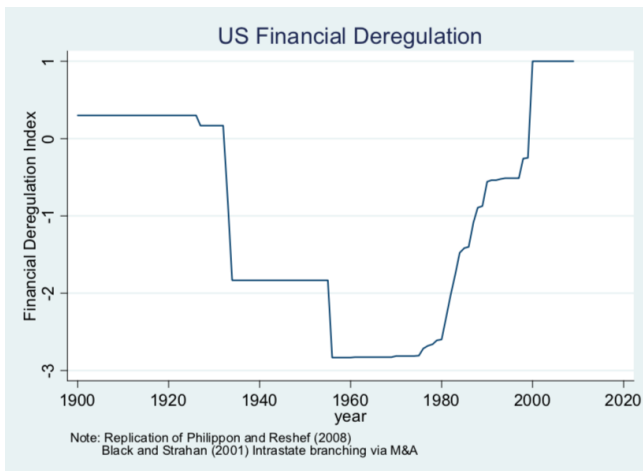
Good Idea to Control for Time Trends



“Trump stood next to a huge pile of paper to showcase excess regulation”

Source: Business Insider.

Problems with Textual Measures Case 1: Different Story Using Policy Measures of Regulation in the Literature



Note: the higher Philippon-Reshef (2012 QJE) index, the lower the banking regulation. Measure based on actual policy on: (i) Bank branching restrictions; (ii) Separation of

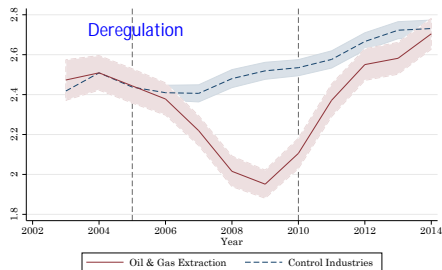
Problems with Textual Measures Case 2: Deregulation & Re-regulation for Oil & Gas

- Comparing Trebbi, Zhang, Simkovic (2023) **Regulatory Compliance Cost** Measure to George Mason text-based measure
- Deregulation: EPA Act of 2005 under Bush administration
- Re-regulation: Executive Order by Obama following BP Oil Spill in May 2010
- Treated: Oil & Gas Extraction (5221)
- Control: Input-Output-Related Industries (2212, 3241, 3251)

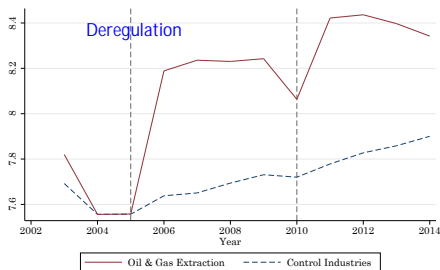
Problems with Textual Measures Case 2: Deregulation & Re-regulation for Oil & Gas

- Comparing Trebbi, Zhang, Simkovic (2023) **Regulatory Compliance Cost** Measure to George Mason text-based measure
- Deregulation: EPA Act of 2005 under Bush administration
- Re-regulation: Executive Order by Obama following BP Oil Spill in May 2010
- Treated: Oil & Gas Extraction (5221)
- Control: Input-Output-Related Industries (2212, 3241, 3251)

Our RegIndex



GM RegData

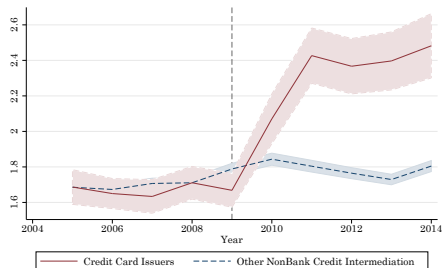


Takeaway: Textual measures cannot distinguish "Deregulation" from Regulation

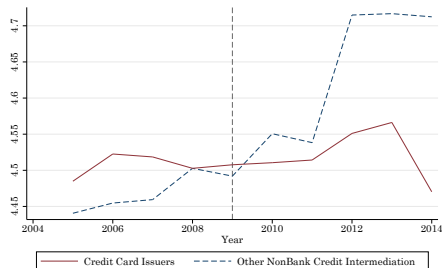
Problems with Textual Measures Case 3: “CARD Act” for Credit Card Issuers

- Regulation: “CARD Act” 2009 for credit card issuers
- Treated: Credit Card Issuers (52221)
- Control: Other nondepository credit intermediation (5222 ex. 52221)

Our RegIndex

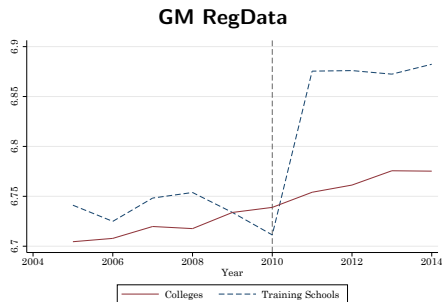
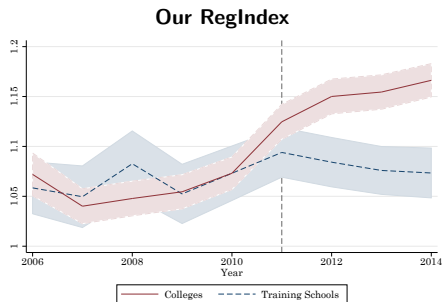


GM RegData



Problems with Textual Measures Case 4: “Dear Colleagues Letter” for Colleges

- Regulation: “Dear Colleagues Letter” from Department of Education in 2011
- Treated: Colleges, Universities, and Professional Schools (6113)
- Control: Other Training Schools (6114-6117)

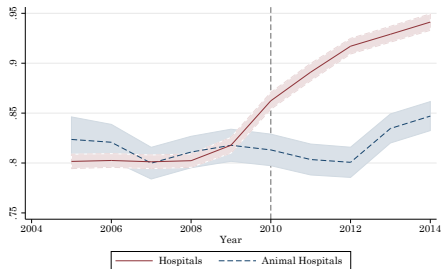


Takeaway: Textual measures that do not focus on content are extremely poor proxies, yielding wrong answers

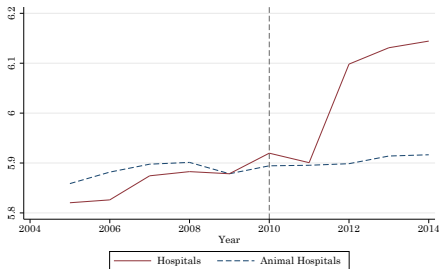
Problems with Textual Measures Case 5: “Affordable Care Act” for Hospitals

- Regulation: “Affordable Care Act” 2010 for hospitals
- Treated: Hospitals (622)
- Control: Animal Hospitals (54194)

Our RegIndex



GM RegData



There are exceptions like this though

Conclusions

- 1 Very stimulating work
- 2 I feel encouraged in pushing for the [quantitative analysis of regulation](#). Great to see interest in Law Schools!
- 3 Consider mine qualified remarks on the quantitative aspects of the analysis. The hope is that they may make the paper more credible