Amherst College
Economics Department
Economics 66
Fall 2010

Discussion Questions for Week 11
Corporate and Financial Law

1. Many people believe that corporations should act in "socially responsible" ways. Some economists, on the other hand reject these requests, arguing that the only "socially responsible" corporation is one that maximizes profits. Should the law seek to promote social responsibility? Or should it look skeptically at corporations that claim social responsibility as one of their goals? Alternatively, should the law be neutral with regard to socially responsible behavior (other than enforcing existing laws)?

2. What are some of the ways that entrenched managements seek to thwart the "market for corporate control"? Should the law always oppose such procedures? Or are there some cases in which preventing takeovers would be efficiency enhancing?

3. The "efficient markets hypothesis" implies that prices for assets that are actively traded will rapidly incorporate all available information. Hence, there would be expected to be no gain from "fundamental" analysis that seeks to predict a company's fortunes nor to "technical" analysis that seeks to discern patterns in past asset prices. Given these insights, why do investors spend so much for advice? Should investment advisors be subject to legal challenge for "fraud". More generally, what kinds of legal constraints on such advisors (if any) would be efficiency enhancing?

4. “Insider trading” is illegal in the United States unless it is divulged through government disclosure forms. What is “insider trading” and why might the law be concerned about it? Do other countries have the same limits on such trading as the United States? What are some possible benefits of relaxing U.S. rules?

5. Recent news has focused on stock options as a possible problem in the incentive structures of firms. Why do firms use options? Why might this form of deferred compensation be preferable to other forms? Does the accounting treatment of stock options matter? What adverse incentives might stock options contain?

6. Successful corporate governance depends on whether directors accurately reflect preferences of shareholders. Do directors actually do that? What are some of the adverse incentives for directors? How might the incentives facing directors be improved? Can the adverse incentives of directors explain “runaway executive pay”?

7. What is a financial “derivative”? What economic functions do derivatives play? How, if at all, should derivatives be regulated?

8. One rationale for extensive regulation of banks is that failure of these firms is more likely to threaten the economy as a whole than would other business failures. Is this view correct? How do existing bank regulations seek to control “systemic risk”? Are there ways in which such regulation should be strengthened? Or will strengthened regulations just move banking business elsewhere?