Bringing Back the State into Regulatory Scholarship

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Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 **Cornell L. Rev.** (forthcoming, 2017), available at SSRN.

In *The Finance Franchise*, Bob Hockett and Saule Omarova take on the dual myths underpinning contemporary financial regulation: that capital is both inherently scarce and privately provided. They painstakingly document (and illustrate in simple graphics for those of us whose banking savvy is confined to remembering their ATM PIN number) the state's role in the provision of financial products and services ranging from plain-vanilla loans to digital currencies. They reveal how, at base, all of these products and services depend on the full faith and credit of national governments to assume ultimate liability for privately-issued debt and to monetize privately-issued debt by allowing the putative private debt-holder to spend the debt proceeds as if they were currency.

In short, Hockett and Omarova demonstrate that because the state serves these two functions, "modern finance is not primarily scarce, privately provided and intermediated but is, in its most consequential respects, indefinitely extensible, publicly supplied, and publicly disseminated. At its core, the modern financial system is effectively a public-private partnership that is most accurately, if unavoidably metaphorically, interpreted as a *franchise* arrangement." (P. 4.)

Why does this matter? Because, Hockett and Omarova argue, the myth of scarce private capital has impeded meaningful systemic regulation of the financial system and has justified policy choices, like austerity, that place control over the allocation of financial resources entirely in private hands. The myth also allows policymakers and those who benefit from inequity in the private distribution of capital to dismiss the resulting social harms as the "unavoidable cost that society must bear in return for a viable market economy." (P. 3.) Hockett's and Omarova's franchise metaphor provides a basis for a "fundamental … attitudinal shift with respect to the proper balance between public and private interests, capabilities, and roles in finance and the broader economy." (P. 64.) Specifically, it justifies an active role for the public, through the state, to make collective, political choices about the appropriate allocation of capital across the economy and to enforce those choices through regulation. *The Finance Franchise* does not present radically new financial regulation policies. Rather, its innovation is to understand that regulatory policies advocated elsewhere by the authors and others are unlikely to be adopted without a "comprehensive analytical and normative justification for thoroughgoing structural reform in the financial sector." (P. 62.)

This struck me as an urgent insight for administrative law and regulatory scholars more broadly. The state has been largely absent from or actively resisted in much legal scholarship. The mine run of legal scholarship has simply ignored empirical and normative questions about the state's role in markets, going about the routine work of analyzing doctrine and proposing regulatory programs based on some unarticulated set of background assumptions about the existence and nature of the state that might implement them. On the one hand, this approach seems unassailable given the state's obvious presence in law and legal institutions like agencies and courts. On the other hand, there is reason to believe that the state's role in regulation can no longer simply be assumed as a static background condition. Indeed, it has become a first-order question.

What kind of state would adopt the regulatory programs painstakingly crafted and persuasively proposed by regulatory scholars? Unfortunately, it turns out, not the kind envisioned by many of their colleagues, who have spent the last several decades resisting the state's role in regulation. Since the mid-twentieth century, economists have theorized states and markets as distinct spheres of human activity and argued that well-functioning markets have superior regulatory capacities to states because of the informational and normative advantages they enjoy.

In this account, government regulation is justified only to correct market failures, and only to the extent that it does so, a significant limit on the type of regulatory role the state may play. New governance scholars have continued the project of distancing the state from regulation, arguing that private collectives like citizen groups and corporations are often better positioned than governments to generate and enforce norms. New economy scholars have taken this project to new heights, culminating in Gillian Hadfield's recent paean to private ordering, *Rules for a Flat World*. Who needs the state when you have the crowd?

These legal scholars have plenty of company in their turn from the state. Every major social science discipline has had such a moment. The irony is that other disciplines long ago reconciled themselves to "bringing the state back in" to a place of theoretical and analytical prominence. Law has come late to this intellectual project, perhaps because the notion that the state ever left the law seems bizarre on its face. Most of us simply assume its existence as an essential and invariable background condition underlying our primary scholarly agendas. Hockett and Omarova are not so complacent. And in a world where the stroke of a pen may wipe out a generation of regulatory and administrative law, none of us should be. We should follow their lead in theorizing not just the law, but the kind of state that will implement it.

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