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"Morality, Rationality, and the Social Meaning of Information: The Institutionalization of Transparency in U.S. Securities Markets"

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Abstract

This paper investigates the history of disclosure regulation in U.S. securities markets in an effort to more fully understand the nature of the recent emphasis on "transparency" as a governance concept. I explore the historical institutional basis for disclosure regulations, beginning with a brief discussion of early objections to the rise of the corporate form in the 18th century. I find that decades of calls for buttressing morality in emerging securities markets were operationalized in the form of disclosure regulation in the early 1930s, but that this chosen mechanism for addressing ethical lapses came to take on a more instrumentally rational meaning over time. The social meaning of information shifted from a challenge to the influence of the corporate form of governance to one that focuses on the safeguarding of individual ability to profit from that form. In recent decades, this has taken the form of requiring an increasing volume of firm data to be disclosed, having the paradoxical effect of stimulating instrumentally rational market behavior. Fairness and morality are no longer seen in terms of individuals versus corporations, but rather as individual's ability to equally profit from corporate finance.

This finding suggests that more attention should be paid to the social-historical meaning of institutions constructed over time, in addition to the functional role played by their current form. I argue that a static, historically neutral approach to examining institutions reduces our understanding of these complex yet necessary elements of the market environment. I also discuss what this case study implies for understanding the nature of rationality in modern securities markets, arguing that much of today's rationality is the functional result of past efforts to buttress morality rather than an intrinsic characteristic of these markets.

Introduction

This paper explores the institutionalization of transparency through a historical case study of the adoption of disclosure regulations that govern U.S. securities markets. A term rarely heard just a decade ago, transparency is now ubiquitous in discussions of corporate governance and market regulation. The essence of the concept is access to information, but already at this most basic point some confusion begins to cloud the term. Exactly what kind of information do actors seek, and more importantly, what is their motivation for obtaining it? In the context of securities markets, the social meaning of information has shifted significantly.

In recent decades, information has increasingly become synonymous with rationality as sophisticated actors seek to convert uncertainty into risk, but robust calls for information on the activities of public corporations dating back to the mid 19th century frame the pursuit of information as a mechanism also for buttressing morality in the marketplace. In the opening lines of *Economy and Society*, Max Weber (1968: 4) defines sociology as the scientific investigation of the causal explanation of social action. Foundational to this effort is an understanding of the subjective meaning that underlies the behavior of actors oriented toward others. Understanding the deeper social meaning of information provides us with a more thorough understanding of what has come to be a central concept in modern market governance.

In U.S. securities markets, transparency is formalized in disclosure regulations. Federal disclosure regulations have become a key institution in the U.S. economy over the last 70 years, but these formal rules have a much longer informal history. Exploring the complete history of transparency affords us the opportunity to better understand several important areas of market behavior. The central finding is that the meaning actors assign to information changes as transparency becomes institutionalized in securities markets, as efforts to ensure morality in early efforts to force disclosure were later overshadowed by a focus on providing information as a method of enhancing profitability and market efficiency. Understanding the history of how transparency came to be institutionalized also teaches us an important lesson about how institutional entrepreneurs accommodate the instrumental requirements of the pre-existing market structure as they seek to strengthen morality in this market and about the longer term unintended effects of enforcing disclosure. The state began a process of institution building by adopting weak disclosure regulations in the early 1930s. This institution would strengthen over time, but as it did it would take on a very different emphasis. With an understanding of the changing meaning assigned to information over time, we are in a position to comment on the nature of information-driven rationality in modern securities markets.

The concepts I have just referred to are explored in the sections below. The following section briefly defines and clarifies terms. Section three documents decades of informal calls for transparency as a way to buttress morality in the changing economic landscape in the years surrounding the turn of the last century. The next section shows how those informal norms were codified in formal federal disclosure regulations governing securities markets as a result of a severe and negative shock to the market. I then look at the way that the focus of providing information shifted between the early years of disclosure regulation and its contemporary form. Here, a review of recent regulatory efforts shows that efforts to facilitate profitability and market efficiency have taken center stage in recent years. The concluding section provides a discussion of the implications of these lessons for our specific understanding of transparency as an institution and how we perceive institutions more broadly. In this section I discuss what an understanding of the social meaning of information does for our understanding of transparency as an institution, and how it affects our conception of rationality in modern markets. I argue that the information-driven rationality of modern securities markets is the functional product of more than 100 years of effort to informally and formally enforce moral behavior by publicly traded corporations. I continue this argument by calling for increased attention to be paid by institutional scholars to the meaning that underlies the formation of the institution and use this call to suggest a specification of how we define institutions.

Definitions and clarification of terms

In this paper we will see that transparency is invoked in different ways over time, but even as its meaning changes a consistent definition of the term remains. Political scientist Ann Florini (1998) refers to transparency as "regulation by revelation" in her discussion of how actors are called to deliberately reveal secrets rather than hiding them. She argues that if democratic governance relies on the consent of the governed, then that consent is meaningless unless it is informed; an informed populace, therefore, requires access to information. In this paper I will follow definition of transparency to mean a structural system of "mechanisms that facilitate the release of information about policies, capabilities, and preferences to outside parties" (Finel and Lord 1999). Thus, transparency is used here to represent a system of continuous release of information. As we will see below, access to this information emphasizes two different concepts over time: morality and rationality.

Beckert (2006) provides a useful distinction between morality and the values and ethics that underlie it. Beckert argues that morality is expressed by "act(ing) in accordance with some principle that is oriented toward the well being of others or the common good and is followed even if it demands to forgo additional personal profit or utility" (109). This definition provides a clear distinction between action and belief, as ethics and values form the underlying beliefs and morality is the conviction to act in accordance with those beliefs. In this case study, morality in the economy implies that actors, primarily those possessing a privileged position such as corporations or market insiders, behave in accordance with the belief that no actor should hold undo privilege or have an unfair advantage over individuals in the economy. In this fashion, acting morally can be realized either voluntarily or by coercive measures.

I consider rational action to be synonymous with maximization along the following lines. When actors behave rationally they process available information in an effort to maximize expected returns, resulting (according to standard economic theory) in resources being allocated to their most productive known use. Sociologists of course recognize that "efficiency" in an absolute sense is never possible, and that rationality is always bounded by constraints on available information as well as capacity to process such information (Simon 1978). But for the sake of the argument here, I give emphasis to the assumption that actors are "intentionally rational," even if they are "boundedly so." In making this distinction, I allow myself the flexibility to consider ideal types, *a la* Max Weber, as a method of coming to understand how such categories of actions and actors behave relative to each other. Morality and maximization here become perspectives to which modern economic actors typically orient their actions.

Since the concept of institutions is central to this paper, I would also like to say something about my use of it. I essentially follow the definition of institution offered by North and Nee and Swedberg, but with some further specification. North (1990: 3) defines institutions as "the rules of the game in a society or, more formally, the human devised constraints that shape human interactions." Institutions shape human interactions by defining the boundaries of acceptable behavior and altering relative costs associated with behaviors. Nee and Swedberg (2005: xxxviii) offer a complimentary definition: "We define institutions as a web of interrelated informal and formal norms governing social relationships within which actors pursue and fix the limits of legitimate interests." These two definitions account for informal and formal components of institutions, and we'll see below that transparency contains both of these elements.

An institutional history of U.S. disclosure regulations: pre-1929

In order to understand the social meaning of information in the context of securities markets we much understand the environment in which disclosure regulations were first adopted. The purpose of this section is to show that calls for morality were embodied in transparency-enhancing disclosure regulations which arose out of opposition to powerful monopolies and trusts in the second half of the 19th century. The concentration of wealth in the U.S. in the late 1800s came to be seen as antithetical to the public interest and a hindrance to individual initiative. As this opposition to corporate power grew, stock exchanges were developing rapidly, drawing in more investors with the promise of high returns on corporate stocks and bonds. During these years, rapid development of this market instrument occurred in an environment characterized by low diffusion of information but high returns on investment, resulting in an enormous speculative bubble in the 1920s. The stock market crash of 1929 brought this period of extravagant gains to a rapid close, and the substantial and immediate loss of wealth resulted in a political imperative to legislate federal disclosure regulations.

The first federal disclosure regulations were passed in 1933, but the passage of such legislation built on decades of recognition that some aspects of the corporate form were antithetical to the public interest. I will begin in the last decade of the 19th century, as the Progressive Era dawned and the political sentiments of the country began to shift towards granting legitimacy to government intervention in the economy. The Progressive Era of American politics was the first time in U.S. history that the state was seen as a legitimate overseer of commercial activity. This era involved and led to a series of intellectual and popular challenges to the rise of unchecked corporate power. Beginning around 1890 and lasting until about 1914, the Progressive Era marked a shift in how many Americans conceived of the proper role of the government. The decades before 1890 were characterized by rapid economic development, Westward expansion, increased industrialization, and a government that sought to stimulate enterprise as much as possible. The later years of the 19th century saw the results of these trends, including technological advances that allowed manufacturing and transportation firms (particularly railroads) to take advantage of increasing economies of scale, rapid urbanization of the population, increasing income inequality, and the entrenchment of an economic elite.

The economic landscape around the turn of the century America came to be dominated by large-scale corporate enterprise. Starting in 1893, a four-year recession facilitated the concentration in ownership of private businesses. By the end of the recession, 4200 private firms had been bought out and merged into 257 corporations (Gould, 2001: 25). Leading the way were financiers like J.P. Morgan who consolidated railroads and manufacturing firms in an effort to exploit economies of scale made possible by the technological advancements of the day. This concentration of resources was formally legal, but was viewed with much concerned skepticism by the populace. William Jennings Bryan commented in 1899, "I do not divide monopolies in private hands into good monopolies and bad monopolies. There is no good monopoly in private hands" (quoted in Thorelli, 1955: 336). It was in these years that vast trusts and holding companies were created, facilitating the control of many large corporations by small group of managers.

The concentration of productive capacity was already a much discussed subject in the popular press some decades before Bryan's commentary. Charles Francis Adams, grandson of President John Quincy Adams and son of the Civil War diplomat of the same name, wrote profusely for popular journals, magazines, and newspapers on a few central themes, among them that industrialization had become a force larger than its human participation could control, and that as a result a gap between corporate and public interests had arisen. The solution to this, Adams argued, was the creation of government regulatory commissions to oversee large corporations (McKraw 1984). Adams actually favored the granting of monopolies to railroads, arguing that maximizing the economy of scale in transportation was the best way to reduce costs for that industry, but there was significant popular opposition to such a notion:

> American culture made such a policy repugnant, if not altogether impossible. Given the nation's past opposition to monopoly, Adams might as well have proposed something as unthinkable as reentry into the British Empire or the restoration of slavery… For Americans, monopoly ultimately implied a foreclosure of those economic opportunities that set New World democracy apart from Old World tyranny. Any argument in favor of any form of monopoly, therefore, bore a crushing burden of negative national prejudice (McKraw: 10).

The move toward public calls for government intervention in the economy was nothing short of a philosophical sea change for the public conscience. Prior to this time, the emphasis had been on the value of individual initiative, and anything that would interfere with a person's ability to pursue his own goals, especially government interference, was antithetical to the American spirit. However, the concentration of wealth and productive resources had the effect of restricting just that: the success of some people's initiative resulted in the restriction of other's. An early example of this was the restrictions that railroad pools began to exert on small businessmen who operated along the rail lines, receiving supplies and shipping goods. A 1873 Illinois State Farmers Association resolution states:

> Resolved, that the railways of the world, except in those countries where they have been held under the strict regulation and supervision of the government, have proved themselves arbitrary, extortionate, and as opposed to free institutions and free commerce between states as were the feudal barons of the middle ages (Heilbronner 1977: 116).

It was the railroad industry that first provided the stimulus for the emerging concentration of capital investment. Railroad ventures required vast amounts of investment capital, as the number of miles of track laid increased from 9,000 to 30,000 in the 1850s alone (Porter 1992).

This expansion was facilitated mainly by private investment rather than government support, and it resulted in the rise of investment banks and capital markets. Acting as arbitraurs, investment banks and the New York Stock Exchange, among other intermediaries, facilitated the mobilization of billions of dollars in investment capital from private hands to the privately owned railroads. Decades later, this market structure and its actors would perform the same duty for other rapidly expanding industries, thus helping to facilitate this rapidly growing concentration of wealth.

Hans Thorelli (1955) offers a highly detailed historical account of the normative, ideological and legal response to this trend. Similar to the other writers discussed in this section, Thorelli chronicles a strong social outrage regarding the concentration of wealth and capital during these years. The unique contribution Thorelli makes that I wish to highlight here is a detailed account of how public opinion against trusts is represented in the press and publications. Thorelli chronicles the widely distributed writings of Henry George, Edward Bellamy, Henry D. Lloyd, and many others. After engaging in an exhaustive study of the popular and academic press, Thorelli concludes that "the study tends to indicate that public concern at the end of the 1880s was serious enough to make immediate federal action against the trusts a clear desideratum, if not an absolute necessity" (143). The views of Bryan, Adams, and Thorelli were objections to the monopoly form itself. During this time, objections largely did not consider specific aspects of monopolies that were particularly detrimental, and early legislative efforts, such as the Sherman Anti-trust Act sought only to ban the development of this form of business. But "big" business resisted efforts to eradicate it, and as time went on accounts of the abuses of trusts and other corporate forms became more detailed.

Louis Brandeis was a primary voice of the Progressive movement, and he emphasized a number of specific abuses inherent in how trusts conducted business. His 1914 book *Other People's Money and How the Banks Use It* documented some of the business practices common to trusts. In this book, Brandeis meticulously details the concentration of financial resources in the U.S., asserting that a "Money Trust" had formed in the country and effectively controlled its economic resources. Far more critical of the growing divergence between corporate and public interests than Adams, Brandeis begins with a discussion of how investment banks expanded their role in corporate finance beyond their original role as brokers that bought bonds from corporations and then sold them to the investing public at a profit, a role that Brandeis considered perfectly valid and beneficial to the economy and the public. Investment banks frequently went beyond this justified role, however, by getting involved as directors on corporate boards, and therefore being in positions to benefit from both sides of corporate finance. This privileged position provided directors with information about the probable sales and purchases of securities that their corporations might make, information that was not available to individual investors. As investment banks, they looked for cheap securities to sell at a mark-up to the public, while as directors of corporations they sought to sell their stocks and bonds for the highest possible price. This position of authority allowed bankers, J.P. Morgan chief among them, to benefit from both sides of these transactions.

Brandeis went on to criticize investment banks for misleading individual investors, as these institutional actors were able to influence the smaller private investor who had few sources of market information on which to base investment decisions except to watch the behavior of investment banks and follow suit. Brandeis was also highly critical of the corrupt practice of forming interlocking directorates, a practice that results in a conflict of interest as the director is in charge of investment decisions on behalf of shareholders in which he has a significant financial stake.

Brandeis was clear in stating that these practices constituted a direct threat to individual investors. It was not the economic threat that Brandeis emphasized, but rather the threat to basic freedoms that underlined his objections:

> Conclusive evidence (if obtainable) that the practice of interlocking directorates benefited all stockholders as was the most efficient form of organization, would not remove the objections. For even more important than efficiency are industrial and political liberty; and these are imperiled by the Money Trust (42-3).

Brandeis goes on to argue that banks are inherently public service institutions, and they should be run not as private firms allowed to be engaged in conflicts of interest, but rather should be operated as public goods because they perform such a crucial role for the economy. Brandeis' suggested that disclosure would root out these hidden conflicts of interest, making his now famous statement, "sunlight is said to be the best of disinfectants; electric light the most efficient policeman." This statement by Brandeis was not a direct call for the type of disclosure regulation that will later emphasize transparency *per se*, but I argue that it is a step in that direction. The writings of Brandeis are a link between earlier objections to aspects of the corporate form, which called for a ban on monopolies in the case of the Sherman Act in 1890, and later calls for transparency because Brandeis begins the process of investigating the particular mechanisms through which abuses take place, and he points out that malfeasance is conducted in seclusion. Thus, we can now see that the harm to the investing public is at least partly a result of the way trusts were developing non-transparent practices, even though Brandeis does not use this particular term to describe it. Later scholars would build on this idea, chronicling more specific ways in which corporate managers use information asymmetries to their own benefit.

Adolf Berle and Gardiner Means (1932) published their classic text *The Modern Corporation and Private Property*, in which they formulated what today is known as the principal-agent dilemma. The modern share-holding firm, they argued, is the first legal form in which the ownership of the firm is separate from control of the firm. In the modern corporation shareholders legally own the firm, while the managers control the firm's day to day operations. The conflict arises because the managers have incentives to use capital provided by shareholders to benefit themselves personally rather than the firm; when "the desire for *personal profit* is the prime force motivating control, we must conclude that the interests of control are different from and often radically opposed to those of ownership" (1967: 114). The level of opposition in the owners' interests relative to those of the managers increases as the managers' share of ownership in the corporation declines, a trend that Berle and Means show was occurring at the time.

Berle and Means go on to detail the specific mechanisms through which investor interests were eroded and managers' interests grew more powerful. First among these causes is the fact that until approximately 1811, corporate charters were individually approved by state legislatures. As a result, all applications for corporate charters were carefully scrutinized, resulting in a contract between the state and the corporation characterized by a high degree of government oversight: "The effect was to set up a business organism conducting a limited enterprise, with participations settled in advance, and safeguarded either by the statutory contract or by the common law in various ways" (125). The replacement of state legislative scrutiny of corporate charters by a more generic application process began in Connecticut in 1837 and most other states followed in the practice over the next 70 years. Instead of being scrutinized in the legislatures, corporate charters were drawn up in the privacy of the firms' attorneys' offices and then filed with the secretary of that state, often un-reviewed at the time of filing or any time after. This trend away from state scrutiny parallels the rise in large scale production, increases in numbers of shareholders, and the granting of wider latitudes of power for corporate managers, as they no longer had to be as explicit about corporate goals in their charter applications.

Another cause of the increasing power of managers is the increased use of proxy voting. Because stock owners were increasingly spread across vast geographic areas during this time, attendance at shareholder meetings declined at the same time that the number of shareholders increased. The result is that most shareholders assign a proxy to vote on their behalf, and "the proxy is almost invariably a dummy chosen either by the management, by the 'control,' or by a committee seeking to assume control." The result is that "the proxy machinery has thus become one of the principal instruments not by which a stockholder exercises power over the management of the enterprise, but by which his power is separated from him" (129). Berle and Means note the moral ramifications of this trend, as it infringes on the foundational principle of individual initiative in the American economy:

> The recognition that industry has come to be dominated by these economic autocrats must bring with it a realization of the hollowness of the familiar statement that economic enterprise in America is a matter of individual initiative. To the dozen or so men in control, there is room for such initiative. For the tens and even hundreds of thousands of workers and of owners in a single enterprise, individual initiative no longer exists. Their activity is group activity on a scale so large that the individual…had dropped into relative insignificance (116).

The writings of Bryan, Adams, Brandeis, and Berle and Means are indicative of the informal opposition first to the concentration of corporate power as exemplified by the rise of monopoly business and the later chronicling specific examples of how big business behaved in a manner harmful to the general investing public, facilitated by the presence of information asymmetries. But opposition to this trend was not limited to academics and the popular press. The U.S. Congress took up the issue of the concentration of economic power in a series of Congressional hearings in 1912. The Pujo Committee, a subcommittee of the House Committee on Banking and Currency, conducted hearings and released an extensive report the following year. This report, and the four volumes of testimony that accompanied it, stimulated the creation of the Federal Trade Commission, the adoption of the Clayton Antitrust Act, and the introduction of legislation to regulate the New York Stock Exchange, all in 1914. Brandeis' work mentioned above was largely based on the statistics compiled by this committee. Titled "Concentration of Control of Money and Credit," the committee's 1913 report made explicit examples of the House of Morgan and three other New York banking firms, documenting how these banks formed what Brandeis would later call the "Financial Oligopoly" (Hacker 1970: 270).

Although the Pujo Committee's recommendations did not result in the passage of legislation to regulate the NYSE at that time, the purpose of including it in this discussion of disclosure regulation is to show that in the early decades of the 20th century, the state joined a large and growing number of intellectual and popular interest groups in raising objections to the continued concentration of financial resources in the country. The state's attention largely focused on the New York Stock Exchange, less because it was interested in the exchange itself and more because the Committee saw it as a centralized point through which it could implement desired changes in corporate governance. Based on the report of the Pujo Committee, the House Committee on Banking and Currency began hearings on the issue of regulating stock exchange in February, 1914. The committee's report clearly frames prevailing corporate behaviors as immoral and contrary to the public interest:

> The general public, which has grown to look upon the exchange with distrust because of the practices that have been permitted, will be given new confidence in it when it is under legal supervision… It is incongruous that such an institution wielding such power and equipped to perform such useful and important functions in our economic system should be uncontrolled by law…
>
> But whether stock exchanges in their wholly local and internal relations may be regulated by Congress or not, where they lend their facilities for transactions injurious to the public interests at large Congress may prevent any instrumentality under its control from being used to multiply and spread such transactions; and it is its obvious duty to do so. It has appeared that sales of stocks on the New York Stock Exchange average $15,500,000,000 annually; that but a small part of these transactions is of an investment character; that whilst another part represents wholesome speculation a far greater part represents speculation indistinguishable in effect from wagering and more hurtful than lotteries or gambling at the race track or the roulette table, because practiced on a vastly wider scale and withdrawing from productive industry vastly more capital; that as an adjunct of such speculation quotations of securities are manipulated without regard to real values, and the false appearances of demand or supply are created, and this not only without hindrance from but with the approval of the authorities of the exchange, provided only the transactions are not purely fictitious. In other words, the facilities of the New York Stock Exchange are employed largely for transactions producing moral and economic waste and corruption; and it is fair to assume that in lesser and varying degree this is true or may come to be true of other institutions throughout the country similarly organized and conducted (115-116).

The above accounts demonstrate that informal opposition to corporate power grew as those powers became more concentrated, eventually leading to state consideration of formal regulation to prohibit it. The federal regulations proposed by the Pujo Committee to regulate the New York Stock Exchange were not adopted, and the measures that the Committee did lead to, such as anti-trust legislation and the founding of government regulatory commissions, were not directly concerned with enhancing transparency but rather with banning particular monopoly practices. But during this era we see early recognition that a number of the specific behaviors of corporations are facilitated by information asymmetries. This section has sought to demonstrate not that disclosure regulation was debated along with anti-trust regulations, but to show that during the era of anti-trust legislation much work was being done to understand the specific mechanisms through which some corporate behavior was conducted that benefited the firm to the detriment of individuals, and that these behaviors were seen to take place in an environment of information asymmetry. Anti-trust legislation would do much to prevent the formation of monopolies, but the rise of the corporate form continued unabated. The following section discusses how this continued rise of the corporate form and the continued presence of information asymmetries harmful to the general investing public would lead to the development of formal disclosure regulation.

The transition from informal to formal: mechanisms and changing meanings (1929 – 1934)

The stock market crash of 1929 would prove to be the event that made federal regulation unavoidable. Unhindered by early and failed efforts to reign in speculation in stock markets in the 1910s, stock markets in the 1920's exhibited what John Kenneth Galbraith (1954) calls 'speculative euphoria,' where post World War I prosperity led to a wave of unregulated, under-informed market speculation. Because there were no government regulations in securities markets requiring disclosure of firm information to investors, many investors traded on hearsay and the assumption that the high rates of return seen in recent years would continue.

A defining characteristic of speculative bubbles is the inevitable crash that marks their end, and 1929 was no exception. The crash wiped out the savings of countless individual investors and banks that invested in the markets. The market lost approximately 70 per cent of its value in October 1929 alone, and 82.6 per cent between that time and July 1932, going from a market valuation high of $89.7 billion to a low of $15.6 billion (Bierman 1991: 120). Individual shareholders, rather than large investment banks or other institutional actors, suffered the worst of these losses. The dramatic decline in equity prices and the devastating losses suffered by investors severely crippled their confidence in the firms and the stock market, and many withdrew from capital markets altogether. This mass exodus from capital markets robbed many publicly traded companies of the financial backing necessary for investment and growth in the same time period leading up to the Great Depression when macroeconomic conditions in the US were not conducive to providing investment capital.

The speculative causes of the crash of 1929 made it politically unacceptable for the federal government to continue to let securities markets go unregulated. The government began hearings on the subject in 1932. In what came to be known as the Pecora Hearings, named for head counsel of the Senate Banking and Currency Committee Ferdinand Pecora, the government's stated intent was to uncover the explanation for the crash. However, the unofficial emphasis, which played a much larger role, was the Senate's politically motivated effort to expose corporate America's extravagant behaviors that resulted in such harm for the investing public (Seligman 1982). Early in the proceedings, the President of the NYSE, Mr. Richard E. Whitney, presented his view of the Exchange, calling it a "perfect institution," self-regulated by its members and engaging only in business that was necessary for the efficient functioning of such a modern marketplace. Mr. Whitney testified that moral arguments in favor of enforcing a sense of fairness on the Exchange were unfounded, arguing instead that the NYSE should remain impartial to how prices for shares are arrived at because the market has its own logic, that being more of less pure supply and demand, that should not be disturbed (Pecora 1939: 259-60). One member of the committee commented on Whitney's unwillingness to fairly discuss the issues at hand:

> Our first witness was Mr. Richard Whitney, president of the New York Stock Exchange, but we did not learn much from him. He denied categorically all bad practices and violations of their rules; he would not admit the possibility of anything wrong. He employed his technical knowledge to dodge issues and confuse the committee. The committee was compelled to depend on other witnesses of the Exchange.
>
> It has been a common saying among the wise ones that markets never go up; they are put up. 'Rigging the market' is well understood among the traders but not by the public. Pools for the purpose of sending the market up or down are common, but we could not get much evidence from the president of the exchange on that subject (Federal Bar Association 1983: 237).

Pecora attacked Whitney's views relentlessly, documenting the liberties taken by the exchange and the listed firms at the expense of investor well-being. Pecora often crossed between investigating the practices of the publicly traded corporations and those of the Exchange, bringing out the abusive practices of each. He framed the NYSE and corporate boards of directors as isolated entities, making decisions that benefited themselves personally with scant consideration of the well being of their investors. Among the illustrative statistics that bore this out, he highlighted the fact that in the decade following World War I, half of the $50 billion in new securities issued would lose all or most of their value (Seligman: 2). He also made a public show of the extravagant spending habits and the excessive executive salaries paid by these publicly traded corporations, details that had nothing to do with causing the stock market crash but much to do with creating an atmosphere of moral outrage over improper use of investor savings. In the end, a similar approach was recognized in these hearings as was by the Pujo Committee: the stock exchange is the nexus through which reforms to corporate governance can be affected.

On March 29, 1933, President Roosevelt sent a formal message to Congress in which he links the lax moral behavior by market insiders to economic losses by investors. Roosevelt's message warrants quoting at length:

> I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.
>
> In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.
>
> Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will profit.
>
> There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that n essentially important element attending the issue shall be concealed from the buying public.
>
> *This proposal adds to the ancient rule of caveat emptor, the further doctrine of "let the seller also beware." It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.*
>
> The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.
>
> This is but one step in our broad purpose of protecting investors and depositors. It should be followed by legislation relating to the better supervision of the purchase and sale of all property dealt in on the exchanges, and by legislation to correct unethical and unsafe practices on the part of officers and directors of bands and other corporations.
>
> What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others (Federal Bar Association: 138-9, emphasis added).

The House of Representatives issued a report in early May of 1933, in which it used Roosevelt's comments to frame its proposed legislation. Section two of the report, titled "The Situation that Demands Action" notes:

> The background of the President's message is only too familiar to everyone. During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The floatation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of

> fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High-pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises (Federal Bar Association: 139).

The emphases in these two statements are that immoral behavior is the target of their efforts to create new regulations. There is also recognition that this behavior had an instrumental outcome, and it is in this discussion of the effects of immoral behavior that we see the state beginning to recognize a more rational, instrumental dimension to what had previously been largely a discussion of ethics. The House Report continues:

> Equally significant with these countless individual tragedies is the wastage that this irresponsible selling of securities has caused to industry. Because of the deliberate over stimulation of the appetites of security buyers, underwriters had to manufacture securities to meet the demand that they themselves had created. The result has been that investment bankers with no regard for the efficient functioning of industry forced corporations to accept new capital for expansion purposes in order that new securities might be issued for public consumption (Ibid: 139).

Based on the findings of the Pecora Hearings, and in an effort to restore the public trust and revive US securities markets, Congress passed two laws designed to regulate securities markets and enhance the disclosure of material information that investors could use to make informed investment decisions: the Securities Act of 1933 and the Securities Exchange Act of 1934. This legislation addressed four fundamental principles:

> First, that the public should be protected from fraud and manipulation, but with the least possible interference to honest business enterprise. Second, the government's role should be limited so as not to be construed as an approval or guarantee of any security. Third, no essentially important element attending the issuance of securities should be concealed from the investing public. Finally, persons sponsoring the investment of other people's money should be held to the

> high standards of a trustee (House Committee on Interstate and Foreign Commerce 1977: 557-8).

An early SEC publication describes the Securities Act of 1933 as follows: "This Act is designed to compel full and fair disclosure to investors of material facts regarding securities publicly offered and sold in interstate commerce, or through the mails, and to prevent fraud in the sale of securities" (SEC 1940). The Securities Act promoted disclosure through two primary requirements: mandatory registration statements by firms and the preparation of prospectuses by dealers. Registration statements contain information on firms seeking to offer stocks for public purchase, such as descriptions of the firm's type of business, its assets, liabilities and other relevant financial information, as well as the type and quantity of securities to be offered. The Securities Act also stipulated that the financial information covered in these categories must be certified by an independent public or private accountant (Pines 1965: 728), but it left to the accounting industry the task of determining particular methods for calculating these. Dealers must offer condensed versions of this information in the form of a prospectus to investors interested in purchasing these stocks. The Securities Exchange Act of 1934 expanded on the effort to force disclosure. The 1934 law added proxy solicitations to the list of regulated disclosure documents. These are documents in which shareholders' votes are sought for the approval of corporate actions, such as the election of directors, at annual meetings. The Securities Exchange Act requires that all material facts relating to the action for which votes are solicited be disclosed. In addition, the 1934 law requires that transactions of company stock by company officials and principal stockholders must be publicly reported.

The 1930s regulations were not adopted out of an attempt to increase rational maximization in securities markets; while there is an instrumental element to any formal regulation, the emphasis of this first round of legislation was still grounded in enforcing morality. Benston notes, "The economic rationale for the regulation of the securities markets was not examined carefully before the legislation was passed" (132). Douglas and Bates (1933) commented on the intent of the Securities Act by noting, "All the Act pretends to do is to require the 'truth about securities' at the time of issue, and to impose a penalty for failure to tell the truth. Once it is told, the matter is left to the investor." Just as Brandeis disregarded the efficiency gains of monopolies as irrelevant relative to the moral questions they represented, improved market returns were not the emphasis of the legislation. Douglas commented in the Yale Law Review in 1934:

> …those needing investment guidance will receive small comfort from the balance sheets, contracts, or compilation of other data revealed in the registration statement. They either lack the training or intelligence to assimilate them and find them useful, or are so concerned with a speculative profit as to consider them irrelevant (quoted in Loss and Seligman 1989: 174-5).

At the same time as the laws were meant to disrupt disreputable behavior, they were also crafted in such a way as to make them acceptable to any honest businessperson. Regardless, there was no small amount of resistance to this new legal framework. This method for strengthening moral behavior was antithetical to the interests of many elite market actors, and these actors held instrumental positions in the market. Morality had to be strengthened, but because the market was an essential part of the public interest, disruption had to be kept to a minimum. A tension thus emerged between efforts to enforce moral behavior in the market and the instrumental requirements of the existing market structure.

In the hostile response of listed firms we see the tension that arises when efforts to institutionalize dominant social norms encounter resistance from instrumental elements that already possess influence in a market seen to be crucial to the public interest. Many publicly traded companies threatened to delist their securities from stock exchanges rather than comply with the new regulations. Firms had the option of moving their securities to over-the-counter markets, which the 1933 and 1934 legislation did not give the SEC the authority to regulate. Stocks traded through over-the-counter markets are sold directly to buyers in private markets rather than going through intermediaries such as formal stock exchanges.

There was much discussion about how far the SEC could push the issue because a sizeable flight of firms to over-the-counter markets would disrupt the operation of financial markets, and in effect defeat the original purpose of the legislation (SEC 1936). The SEC at this time only had the right to regulate firms listed on traditional stock exchanges; it could neither force firms to list on these exchanges nor prohibit them from leaving these markets and entering the unregulated secondary markets. The proposed regulations were seen to benefit investors, but these gains would not be realized if there was a mass delisting of firms. Therefore, the SEC had to find a way to increase regulatory intensity without disrupting existing markets. Thus we see the tension that arises when the state's attempt to legislate normative values is disruptive to an existing market structure. By the time the state decided to reinforce moral behavior by requiring a higher degree of transparency, a market structure had evolved that simultaneously was a vital component in the national economy and threatened to undo the economic well being of the country through the detrimental effects of progressively non-transparent behaviors. The state needed to enforce transparent behavior as a method for re-strengthening morality in the market, but it could not disrupt the instrumental structure of the market to do so.

The SEC adopted a two-sided approach. First, they compromised on several corporate demands in order to prevent a high rate of delisting. The original provisions were amended in

1936, declaring that firms whose securities were traded before March, 1934 were excluded from many of the new disclosure regulations. In a 1938 review of all categories of securities listed on national exchanges in the U.S., Smith (1938) finds that just under ¼ (1084 out of a total of 3800) of all securities listed in the U.S. were exempt as a result of these federal concessions. 657 of these were listed on the NYSE, out of a total of 1889 listed securities on that exchange. Another part of the 1936 amendments stipulated that the periodic reporting requirements of the Securities Act would only apply to firms whose securities were valued at more than $2 million. While the SEC and Congress both recognized these compromises as antithetical to the intent of the original legislation, they admitted that they were a necessary step in implementing a longer-term, workable disclosure environment (House Committee on Interstate and Foreign Commerce: 585-7). This longer-term vision for compliance relied on the increased legitimacy of firms that remained in these markets and met the increased regulatory demands. When investors came to see compliant firms as more trustworthy, they would be more willing to invest in these firms, and this served as a lever for forcing increased compliance by other firms. Rather than legislating compliance, the SEC can be said to have installed a system in which compliance to regulations created an environment in which investors sought out transparent firms, stimulating a market demand for SEC compliant firms.

Empirical tests of this thesis have been conducted but without confirming efficiency gains resulting from the adopted disclosure regulations. Benston (1973) tests the economic effects of the disclosure regulations, questioning whether the regulations resulted in less variance in stock returns or if overall market efficiency was improved by directing flows of capital to more productive enterprises resulting from mandatory firm disclosure. Benston's analysis rejects both of these hypotheses, noting that "the disclosure provisions of the '34 Act were of no apparent value to investors" (149). Greenstone, Oyer, and Vissing-Jorgensen (2006) consider several other empirical tests of the effects of these regulations, finding little consensus in the empirical evaluations of the economic effects of the 1933 and 1934 disclosure laws. Coffee (1984) argues that fundamental market conditions changed so dramatically in these early decades of disclosure regulation that no comparison between time periods is possible.

It is my argument here, however, that the actual economic effects of the regulations in the 1930s were not their salient features, at least not in the narrow sense. Instead, these rules were intended to codify popular informal social norms in securities markets. Stinchcombe (2001) discusses the process through which the formalization of an informal belief must match the former to the latter. In this case, the need to enforce a stronger sense of morality (the informal element) required the adoption of a formal mechanism. This formal mechanism took the form of disclosure regulation. The state did not intend for its formal mechanism to convey an instrumentally rational approach to the pricing of securities. In a 1933 House Report that preceded the passage of the Securities Act of 1933, the state explicitly recognized that it had chosen disclosure regulation as its mechanism for providing information on publicly traded firms, but it also sought to avoid the connotation that this approach was any attempt to facilitate positive outcomes:

> The mechanism devised by your committee for compelling disclosures and for insisting that disclosures shall be both adequate and true has been carefully framed, so that neither action nor nonaction by the Federal Trade Commission can be interpreted as a guarantee or approval of any particular security issued (Federal Bar Association: 141).

Regardless of their intention, however, any formal effort to enforce the informal values that underlie this issue would necessarily take on instrumental qualities. Any legal mechanism adopted would alter relative costs for certain behaviors, leading to an instrumentally rational frame for the new regulations as firms are forced to consider the costs of actions now prohibited by law. The following section demonstrates that this transition has in fact taken place; I then discuss its implications in the final section of the paper.

The decades after formalization: an increasing concentration on efficiency and maximization (mid-1930s – today)

Even though the original intent of the aspects of the 1933-34 regulations which require disclosure was not to create a system of information delivery that would emphasize rational maximization, the state's choice of mechanism for enforcing morality had unavoidable instrumental qualities. As is often the case with such legal issues, the state's approach was neither entirely comprehensive nor perfectly implemented. As a result, frequent specification and expansion of the laws was needed to account for a number of areas of concern that were either not addressed in the original regulations or arose from changing market conditions. Congress and the SEC were in a process of almost continuous revision as they tried to find the most efficient method of enforcing information disclosure. By 1982, the disclosure regulations passed in 1933 and 1934 had been amended on no fewer than 37 occasions, and many of those amendments changed several aspects of the law.

In 1964, for example, disclosure requirements were extended to include securities traded in over-the-counter markets, bringing this previously unregulated domain under government supervision. By 1974, the SEC recognized that the primary method of regular contact between firm management and ongoing shareholders was the annual report, but these annual reports contained much less detailed financial information than the firm provided to the SEC as required by the 1933 and 1934 laws and their subsequent amendments. Shareholders did not have regular access to the firm's SEC filings, which contained highly detailed information, as required by law. These SEC's strengthened ongoing disclosure by firms to shareholders by requiring that many categories of information normally reported to the SEC be included in these reports also, including financial statements for the two previous years (certified by independent accountants), operations summaries for the previous five years complete with an analysis written by management that highlights important changes in the last three years, a brief summary of management's view of the current nature and scope of the corporation's business dealings, detailed information on each of the firm's directors, and the range of market prices paid for the firm's securities over the last two years (SEC Annual Report 1975: 40). The SEC's intent in requiring management to write its own summaries of vital firm activities was to make the annual statement digestible to individual investors, who were not trained to analyze financial accounting data but could more easily understand an editorial form of disclosure (House Committee on Interstate and Foreign Commerce: 617). This move to formalize the availability and accuracy of such information began informally ten years earlier, when the SEC in 1964 required that any discrepancies between a the accounting principles used in a firm's SEC-filings and those released in periodic reports to shareholders, including annual reports, had to be explained in the latter (Zeff 1972: 222). Amendments to the Securities Act and the Securities Exchange Act required a growing quantity of disclosure documents, so much so that in 1967 the SEC formed an internal study group to make recommendations on how the disclosure requirements of each act could be simplified into a more standardized disclosure process. The result was the development of a system of standardized forms for disclosing particular information. Today, there are 37 different standardized registration forms covering requirements of the Securities Act and 17 registration forms that address Securities Exchange Act requirements. In an effort to make such an extraordinary amount of information more accessible to investors, the SEC today organizes all disclosure documents by publicly traded firms into a searchable online database.[1]

Let me now turn to two prominent examples of recent regulatory efforts by the SEC and Congress as they continue to work to specify and strengthen disclosure regulations in a changing market environment. These two examples highlight how market efficiency has come to take on a strong emphasis in the pursuit of transparency, shifting away from the ethics-based reasons that were prominent in the adoption of the first federal regulations. Fairness is still referred to in these recent regulations, but it has also come to take on a meaning synonymous with maximized returns and the facilitation of market efficiency. I introduce both recent examples first, followed by an argument on how they demonstrate a change in the social meaning of information and the state's and investors' conception of morality and fairness.

On October 23, 2000, the SEC implemented Regulation Fair Disclosure (Reg FD). The intention of Reg FD is to end what the SEC calls "selective disclosure," which is the disclosure of material, nonpublic information to a select group of individuals. 'Material' in this sense implies information that is likely to alter a firm's stock price. A typical example of selective disclosure is when a company official discloses quarterly earnings data to an analyst or other representative from a brokerage that then uses that information to buy the stock if the data is better than expected, or sell the stock in the opposite case. In either case, the 'insider' is able to trade according to information not available to other market participants. By the time this information becomes public, the insider has been able to avoid losses or secure gains that would not have been possible without advance warning. Selective disclosure often results from

[1] See www.sec.gov/edgar/searchedgar/webusers.htm for more information.

company efforts to curry favor with analysts, who in return for insider information issue excessively positive reports about the firm - a practice that typically raises share prices.

SEC Chairman Arthur Levitt (2002, 87) recognized selective disclosure as an unfair trading practice that unduly benefited industry insiders at the expense of public investors. In its announcement of the final rule, the SEC states:

> We believe that the practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets. Investors who see a security's price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders (SEC 2000).

In testimony before the House Subcommittee on Capital Markets, Insurance, and Government, the SEC issued a formal statement one year after adoption of Reg FD which summarizes the need for additional regulation in this way:

> Selective disclosure raises several concerns. The primary issue is the basic unfairness of providing a select few with a significant informational advantage over the rest of the market. This unfairness damages investor confidence in the integrity of our capital markets. To the extent some investors decide not to participate in our markets as a result, the markets lose a measure of liquidity and efficiency, and the costs of raising equity capital are increased. Further, if selective disclosure is permitted, corporate management can treat material information as a commodity to be used to gain or maintain favor with particular analysts or investors. This practice could undermine analyst objectivity, in that analysts will feel pressured to report favorably about a company or slant their analysis to maintain access to selectively disclosed information. Thus, selective disclosure may tend to reduce serious, independent analysis (SEC 2001).

The SEC's answer to this problem is to require that material, nonpublic information disclosed to one source must also be simultaneously disclosed to the general public through a variety of sources, including press releases, public access conference calls in which all interested investors can listen in and web casts of data releases.

The adoption of Regulation Fair Disclosure was a significant new disclosure rule, and its application to our discussion of the changing nature of the institution of transparency is discussed below. But before that discussion it is necessary to also address a recently-adopted milestone in corporate disclosure regulation: the Sarbanes-Oxley Act of 2002. Sarbanes-Oxley is so far the most comprehensive, far-reaching legislative effort to stimulate disclosure and influence corporate governance since Congress passed the Securities Act and Securities Exchange Act in the early 1930s (Harvard Law Review 2003: 2123).

The wave of corporate scandals in the late 1990s, including multi-billion dollar write-offs by firms such as Enron, WorldCom, Global Crossing and Tyco, created an atmosphere ripe for legislative action not experienced since the stock market crash of 1929 resulted in the passage of the Securities Act and Securities Exchange Act in the early 1930s. Senator Paul Sarbanes introduced draft legislation which proposed a revamping of corporate governance and disclosure regulations to the Senate in early June of 2002, just following the Enron collapse. The bill received little support until a few weeks later when it was announced that WorldCom had also restated its corporate earnings, reducing its earlier estimates by almost $4 billion. Following this news, public outrage was strong and sudden, resulting in a climate where Congressional action was all but guaranteed. Texas Senator Phil Gramm noted at the time, "In the environment that we're in, virtually anything could have passed the Congress" (Bost 2003: 4-5).

Ohio Representative and co-sponsor of the bill Michael Oxley summarizes the intent of the legislation and provides the context of the new rules when he presents the final version of the Bill on the House floor:

> I bring to the floor today a tough, sensible conference report that responds in a measured way to the very real crisis of confidence among America's 85 million investors.

Make no mistake, this is a difficult period for those who love and cherish the free enterprise system. Since early 2000, our capital markets, although still the most respected in the world, have unquestionably suffered a series of blows- mostly self-inflicted- which have truly damaged the public's faith in the integrity of corporate America.

The Senate built on the House bill's chief objectives, strong oversight of accountants, increased corporate responsibility, and improved information for investors.

This legislation, combined with the truly substantive and far-reaching reforms proposed by the industry's self-regulatory organizations and the brutal and unforgiving market forces, will help restore faith in the system. A strong dose of character, honesty, and ethics would not hurt either.

For two decades in Congress, I have advocated a free market approach to regulation, but I also believe that capitalism can only flourish under the rule of law. Those views are not at odds. In fact, they are quite consistent. Government must be careful not to overreach and stifle the entrepreneurial spirit that has made the United States the most successful economy in the world. At the same time, government has a responsibility to punish- and do so swiftly and severely- those who seek to cheat and steal from others.

Investors will now get better information and will get it faster and they will have more faith in the numbers because the accountants will be more vigilant, as will audit committees (Congressional Record 2003: H5462).

Rep. Oxley clearly frames this legislation as a "free market approach" to regulation, one in which an emphasis is given to disclosure of information that investors can then process in an effort to achieve maximized returns. This emphasis does not eliminate a continued call for ethics in securities markets, but the emphasis has shifted from morality and ethics toward, although not completely to, information-driven rationality as the instrumental focus that arose out of this legislation is best summarized as an effort to facilitate rational decision making by investors via a strengthening of accounting principles and through the identification and weaknesses in enforcement of disclosure standards in the U.S. The SEC summarizes its Congressional mandate resulting from passage of Sarbanes-Oxley:

The recent spate of major corporate accounting scandals suggested that our system of corporate governance and financial reporting is in need of improvement. To many it appears that, at least in some cases, the checks-and-balances within the financial reporting system-ranging from management to

> auditors, audit committees, boards of directors, analysts, rating agencies, corporate counsel, standard setters, regulators and the investors themselves-failed to prevent or detect large-scale fraud in major corporations which were carried out over extended periods of time. While we believe the financial reporting system remains fundamentally sound, and, generally, of the highest quality, these failures were a call for action.
>
> Congress responded by passing the Sarbanes-Oxley Act of 2002 ("the Act"), the most significant piece of securities legislation since the 1930s. Much of the Act may be viewed as a legislative attempt to better align the incentives of management, auditors and other professionals with those of investors.
>
> In sum, the Act called for improvement in the checks-and-balances that govern the production of financial information provided to investors and, thereby, served notice on bad actors that they would be discovered and dealt with for their misrepresentations. But the logical question loomed as to whether these actions addressed completely the causes of these financial scandals. Many asked whether, beyond the bad actors, the accounting standards themselves might have played some role in facilitating or even encouraging the bad behavior (SEC 2002a).

The S-O Act was signed into law in July 2002, containing several provisions that are illustrative to our study here. Section 302 is a symbolically important part of the law; it requires executives to personally certify that their disclosure reports are accurate:

> Section 302 of the Sarbanes-Oxley Act requires the principal executive and financial officers of a company filing periodic reports to certify in each quarterly and annual report, among other things, that the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, not misleading, and the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the company (SEC 2003a).

Section 404 of the Act stipulates that company management must submit an annual report discussing how the company controls its financial reporting, including a review of how its independent audits were conducted for that year (SEC 2003b). This section seeks to strengthen the quality of disclosed information by certifying that the firm’s independent auditor adheres to standardized accounting principles in compiling the firm’s quarterly, annual, and other reports.

Section 906 of the Act makes it a criminal offense to knowingly falsify financial information in any periodic reports.

Several sections of the law directed the SEC to conduct studies of patterns of past violations of securities laws in an effort to understand areas of existing statutes that are frequently violated. Section 704 called for an accounting of the areas of existing statute that are most frequently abused. The SEC's report found that the areas most vulnerable to abuse by firms are revenue recognition, expense or cost recognition, and disclosing information regarding mergers and acquisitions (SEC 2002b). Section 703 called for a special study of the most frequent abuses by securities dealers; this study was essentially a market-side study that mirrored the study of firm abuses. This study found that in a four-year period from 1998 to 1991, 1,569 securities professionals had been cited with violations of SEC statutes. The most frequently violated provisions were anti-fraud regulations, followed by violations of securities registration rules and failure to register broker dealers (SEC 2002c). Section 308 called for a study of financial and legal obstacles to obtaining financial compensation for defrauded investors.

The emphasis of the Sarbanes-Oxley Act is on strengthening accounting standards that facilitate improved investor confidence in disclosed firm information, following the wave of corporate accounting scandals in 2001. This focus on accounting standards and the certification of firm disclosures speaks directly to the argument that the social meaning of information has changed since the advent of these regulations 70 years ago. Investor confidence is still the targeted result, but the manner in which confidence is earned, the manner in which "fair" and "moral" behavior is exhibited in securities markets has changed from a challenge to the influence of big business to attempts to safeguard individual investor's ability to profit from it.

The framing of the issues that underlie the passage of both Sarbanes-Oxley and Regulation Fair Disclosure cites values such as fairness and confidence as the essential elements, but this is a different moral objection than we saw in the early 1900s. At the turn of the last century, objections were directed toward the rise of big business because of the threat to individual initiative that type of organization posed, what Brandeis called "industrial and political liberty." The framing of this tension we see in the discussion of Sarbanes-Oxley and Reg FD is considerably different. Instead of objecting to the threats posed by the corporate form, moral objections are raised when individuals do not have full access participate in realizing potential benefits associated with corporate finance. A century ago the issue of morality pitted individuals against corporations, but today the concern is over allowing all individuals to participate in that exact process they protested against a century ago.

The language of fairness and morality is used consistently over all time periods to note that its absence hinders proper functioning of securities markets because when fairness is damaged, investor confidence is reduced and individual investors exit the market and it is therefore weakened. The main point I wish to make here is that the basis of securing that confidence, that fundamental reassurance that convinces investors they are being dealt with "fairly" in the marketplace, has shifted considerably since the Progressive Era. "Fair" is no longer framed as a struggle between corporations and individuals competing for equal opportunity to express initiative, as it was at the turn of the last century. Instead, fairness here is framed as everyone's right to profit from big and other business. The struggle is no longer against 'bigness'; it is now about being able to profit equally from big and other business. A more detailed discussion of this change follows in the next section.

Although the social meaning of information changed between the adoption of regulations in the 1930s and those of recent years, one fact that has not changed is the opposition that firms express to regulations. Represented by the Securities Industry Association, a national lobbying organization, institutional investors as an industry broadly resisted the implementation of Reg FD because they were unwilling to give up their ability to draw on non-public information that increased their ability to realize positive gains. They claimed that instead of leveling the playing field by reducing the flow of privileged information between firms and themselves, Reg FD would reduce the total amount of information disclosed by publicly traded companies. The Securities Industry Association (SIA), a professional organization representing hundreds of securities firms, led the lobbying efforts against Reg FD by arguing that companies would use the excuse of the fear of liability and prosecution under the new law to cut off all nonessential communications with market actors, effectively reducing the total amount of information available to the markets about a company's activities.

> In the view of these commentators, issuers would find it so difficult to determine when a disclosure of information would be "material" (and therefore subject to the regulation) that, rather than face potential liability and other consequences of violating Regulation FD, they would cease informal communications with the outside world altogether (SEC 2003c).

The SEC was not convinced that such severe repercussions would occur, but nevertheless it did compromise on some minor aspects of the new rule. The SEC responded to industry concerns by better specifying what information is considered 'material' and which personnel should be restricted from engaging in selective communications, as well as reducing the penalties should a violation occur. These concessions were meant to ameliorate industry concerns and reduce the possibility of firms using the new rule as an excuse to not disclose important information to market participants. However, the SEC's resolve to pass the more stringent regulations was not deterred in any meaningful manner.

The passage of Sarbanes-Oxley led to the reemergence of the issue of firms threatening to delist from stock exchanges in protest. However, the threat of joining unregulated over-the-counter markets, a threat made by firms in the 1930s, is no longer valid since these markets came under SEC regulation in 1964. Now firms must consider trading their publicly traded status for a return to private ownership. Reports in the popular business press indicate there is a significant debate going on currently between regulators and publicly traded firms. Firm representatives frequently cite the significant financial costs of compliance with the Act, and small firms especially find that providing all the necessary certifications of internal controls and outside audits is costly and time consuming. Critics of Sarbanes-Oxley argue that the unreasonable and costly nature of compliance with this law leads firms to delist from stock exchanges and revert back to private ownership. One private report issued in April 2003 states that the rate of businesses reverting to private ownership increased 26 per cent after passage of Sarbanes-Oxley, a direct result of the increased cost of compliance needed to remain publicly traded (Francis-Smith 2003). A December 2004 study by professors at University of Pennsylvania's Wharton School of Business claims that 198 firms chose to delist in 2003 compared to only 67 in 2002 (Loftus 2004). *The Wall Street Journal* quotes the latter report, stating '"We basically find that going dark can serve as a way to conserve cash but it may also be exploited by insiders trying to avoid the scrutiny of the market" because "they are not managing the firm in the most efficient way or because their compensation is excessive."

The SEC recognized that these requirements were disproportionly difficult for smaller firms, and not unlike the concessions made to some firms over issues of disclosure compliance from the 1930s legislation, they somewhat reduced the demands made on smaller firms. For example, firms with less than $75 million in market capitalization were given until 15 July 2006 to demonstrate compliance, the equivalent of a one-year extension (Solomon 2005). However, many top policy makers openly stated that the delisting of smaller firms might actually be in the best interest of the market, a significantly stronger stand against corporate resistance than the SEC could muster in the early 1930s. Former Federal Reserve Bank Chairman Paul Volcker and former SEC chairman Arthur Levitt argue that a migration of some smaller firms back to private ownership could be good for the health of the securities market:

> In any other time but the overheated markets of the past decade, they [small firms] would not have gone public in the first place. Our hunch is that Sarbanes-Oxley is but an excuse for a movement into private control that should occur anyway. Furthermore, if a company does see the certification of the effective internal controls as a burden, then it should neither be public nor attracting investor's money (Volcker and Levitt 2004).

This willingness by the state to allow some firms to delist rather than weaken the regulations shows a significant change its approach to firm objections compared to the 1930s. Congress and the SEC were under pressure to avoid a mass de-listing of firms in protest to the 1930s legislation, but the quote above from Levitt and Volcker shows how this has changed. While capital markets are just as crucial to the national interest today as they were in 1933, the approach taken by the state is that these markets can be made even stronger if those firms that are too weak to comply with the new regulations exit the market. Instead of seeing de-listings as bad for the market, in brief, they are considered valuable. As the weaker firms are forced to exit, a stronger marketplace is the result.

Discussion: toward a deeper understanding of institutions

In one of the foundational articles in the new institutional economic sociology, Meyer and Rowan (1977) argue that firms must conform to an institutional environment made up of a set of social preferences that have been solidified and entrenched over time, such that these preferences become influential not because they have evolved into formal rules *per se* but rather because they have become "institutional myths" that actors feel obligated to uphold in order to convey organizational legitimacy. DiMaggio and Powell (1983) soon added to this argument by seeking to explain the high degree of homogeneity in organizational forms, finding that strong isomorphic forces result from the presence of strong institutional environments which punish actors that deviate too significantly from the prevailing accepted model.

This focus on firm response to an external institutional environment was in part a reflection of the influence of the study of organizational behavior by sociologists in business schools in the 1970s and 1980s, a time when economic sociology was being revived in its modern form (Yenkey 2006). Although Meyer and Rowan account for the institutionalization of a norm over time, their focus on firm response to environmental stimuli emphasizes the current manifestation of the institution as the causal mechanism in determining portions of firm behavior. In this section of the paper, I would like to raise the question if in addition to understanding the influence an institution has in its current form, a deeper understanding of the meaning of the institution would demand historical knowledge of its coming into being?

After considering one particular historical case, I have reached the conclusion that the information-driven rationality characteristic of today's securities markets is the functional result of efforts to strengthen morality in the 1930s, an effort which came to rely on the adoption of disclosure regulations in the 1930s. This effort built upon earlier opposition to the rise of monopoly businesses, which directly called for the criminalization of the monopoly form rather than increased transparency. While monopolies were more effectively controlled, the rise of the corporate form continued as did a number of practices harmful to the public interest, which scholars at the time pointed out were partly made possible as a result of managers having privileged access to information not available to the investing public. This opposition to the privileged access by corporate insiders began informally years prior to the adoption of the 1930s regulations, but it was through the adoption of formal securities regulations in 1933 and 1934 that the emphasis came to be centered on disclosure as the mechanism through which such harms might be avoided. The expansion and specification of these rules over the next 70 years then resulted in an increasing depth and breadth of disclosure requirements that today drives the production and dissemination of information which helps to facilitate intentionally rational maximization by the investing public. The paradox I note in the paper is that this information was originally made available as a result of efforts to insure moral behavior in the marketplace, *not* as a way of aiding rational decision making *per se*. We already know that rationality requires transparency because transparency provides the information that is needed for making rational decisions. But the historical investigation of the institutionalization of transparency reveals that in this case the relationship is *sequential*- the formal norms which make information available and facilitate efforts toward rational maximization were made possible only as a result of the codification of the informal norms of morality, understood at the time as a protection of individual interests threatened by the growing power of corporations.

The social meaning of information changed, but so did the meaning of morality and the conception of what constituted fairness. The role information plays in monitoring corporate activities is unchanged, but the reason why the monitoring takes place has changed. Gone is the era of protecting individual initiative against big business; now the monitoring efforts of disclosure regulation seek to level the playing field across all types of investors, theoretically granting all actors an equal chance to profit from a firm's activities. Individuals were skeptical of the corporate form early in its conception, as we saw in the popular and academic writings of the Progressive Era above. However, many actors were drawn into purchasing corporate securities in the 1920s, lured by the promise of high returns. As a result of this, skepticism of the form gradually gave way to an acceptance as profits were realized. The Crash of 1929 served as a wake up call, but by this time investors were committed to this market mechanism. Rather than question its basic function, the state sought to enforce a safer version through disclosure regulations, in an effort to convince investors that they really could know enough to be safe in this market. Today, that feeling of safety is the central issue; confidence is not a question of the market mechanism or of the corporate form itself. The sense of morality in contemporary markets now depends also on the ability of individual investors to participate in this market on an even playing field with "insiders." Fairness and confidence are now to a large extent considered in terms of access.

The original legislative emphasis on morality and the later emphasis on access, however, both have to be secured through regulation, and regulation necessarily has instrumental elements. In the early years of regulation, the state's effort to specify mechanisms through which morality might be strengthened led to a tension between the instrumentally rational goals of strict disclosure rules and the ethics-based morality these rules were meant to enforce. The result yielded some unintended consequences. The SEC required independent accountants to certify firms' disclosure documents, but it did not provide the accounting principles with which such information would be calculated. The end result, as we see in the discussion on Sarbanes-Oxley, is that over the course of several decades the accounting industry came to provide a complex patchwork of disclosure information, such that its complexity was counter productive to its original intent of facilitating disclosure of information that would serve to first monitor corporate behavior and later provide individual investors a basis on which to make more rational investment decisions.

Such unintended consequences of efforts to formalize transparency call into question the efficacy of such rules. To what extent does this federal effort to enforce transparency actually produce the desired state of rational maximization? Many studies question the ability of investors to reach, in any meaningful sense, an objective understanding of the operations of complex modern corporations. Hatherly, Leung, and MacKenzie (2005) show, for example, that corporate financial accounting is a process involving such a high degree of discretion that even the strict rules stipulated by accounting conventions cannot show once and for all what must go into the reporting of corporate profits.

Bloomfield and O'Hara (1999) have found that disclosure results in decreasing liquidity and less informed traders because disclosure reduces the central role of the market maker in securities markets; when the market maker is circumvented, a result of free access to information by all actors, the market maker has less incentive to maintain an orderly market for a security. Coffee (1984) argues that mandatory disclosure actually serves the public interest by providing information to institutional investors that would not exist otherwise due to the tendency of such actors to free ride, leaving data to be collected by others. The case of Reg FD, however, was called into being because of the ability of some market actors to cull favor with inside informants. The continual re-specification and strengthening of disclosure regulations itself demonstrates that the struggle to provide accurate information to all actors is ongoing, lending additional support to Hatherly et al's argument that achieving any kind of objective level of transparency is not possible. It is worth mentioning again that the earlier review of the economics literature fails to produce any study that finds disclosure regulation contributing positively to market efficiency.

Regardless of these concerns whether disclosure regulations can indeed provide an instrumentally useful level of information, much can be learned from this case study regarding our understanding of institutions. I argue that the sequential nature of the development of transparency allows us to raise questions about the definition of institution. While I agree with North and Nee and Swedberg that an institution is an interrelated mix of informal and formal elements, the historical case considered here demonstrates that seeing disclosure regulations as a mix of formal and informal elements will only help us understand what the *current* form of the institution is. Seeing an institution for what it is implies that we take a static view of the institution. But because institutions change over time, a fact well known to sociologists, we must also account for the *process* through which the norms in question are institutionalized. In order to understand the full meaning of the current form of the institution, we must also understand how that meaning evolved. When we account for the sequential nature of the relationship between the informal and formal elements of disclosure regulations, we see that that the stages undergone during the process of institutionalization have distinct and different emphases. The case of disclosure regulation is an example of how crucial meanings change over time, and considering only the current form gives a functionalist understanding of the institution. Early abuses committed by corporate insiders, such as the conflicts of interest that investment banks were involved that Brandeis called attention to or the unfair conduct of early proxy votes noted by Berle and Means, were facilitated by the presence of information asymmetries. While scholars and legislators did not call explicitly for transparency-enhancing regulation, they did call attention to the abuses made possible by non-transparent corporate behavior. Explicit emphasis on disclosure began with the Securities Act of 1933, and since that time the emphasis of federal regulations has been the systematic disclosure of material information. The key finding of this investigation, however, is that the normative emphasis in meaning for enforcing disclosure has changed since its first adoption in 1933. After the informal norm was codified into formal federal regulation, it began to change in its meaning, growing more and more rationalized over time. This process was facilitated by decades of opposition to the rise of the corporate form. Many early regulatory efforts emphasized criminalization of monopolies and trusts, but over time these corporate forms were also found to be antithetical to the public interest as a result of behaviors conducted out of sight of public view. Understanding how these events eventually led to the establishment of a system of disclosure regulations, even though disclosure itself was not the emphasis in early regulatory efforts, enhances our understanding of the evolving meaning of the institution.

I am not alone in calling for this kind of approach. A number of scholars pay close attention to the historical evolution of institutions. Greif (1994) has shown how the cultural backgrounds of the Maghribi and Genoese traders led to the development of distinct systems of contract enforcement, with that of the Genoese facilitating greater efficiency in long distance trade. A recent line of research that investigates the role of social movements in forming institutions also offers much promise into accounting for the underlying meaning of institutions. The volume edited by Davis, McAdam, Scott and Zald (2005) contains several insightful articles that explore the processes through which institutionalization occurs as a result of larger scale social movements. Haveman, Rao, and Paruchuri (2007) account for the unintended effects of social movements on institutional formation by showing that the ethics of the Progressive Era led to the formation of several new institutions, but that those institutions only partially retained the values that led to their creation.

A number of sociological institutionalists are also concerned with the function played by the norm. Much has been learned from these studies about the effects of institutions, but much work still remains to be done in order to understand the institutions themselves- where they come from and what they mean. It would seem that one can ask two questions about an institution: what does it do, and why does it do it? These are both important questions to ask, but I argue that studying the "why" of institutions provides a more thorough understanding of these complex structures than is possible when we only consider the role that they play in their current form.

Ingram and Clay (2001) somewhat bridge these two areas of interest by arguing that we need to pay more attention to the role played by actors' interests in the creation of institutions. However, these authors focus on a rational, instrumental conception of interest. They focus largely on the state's role in enabling credible commitment, with regulation serving to reduce transaction costs between exchange partners as the state credibly commits to avoiding market-disrupting subsidies and engaging in rent seeking. But is the state's motivation for regulating market transactions always oriented toward market efficiency, or does it sometimes act to formalize the moral beliefs of the society regarding market transactions? The case study presented here indicates that it does.

Moral considerations clearly play a role in the creation of other legal rules; theft, murder, and many other criminal offenses are forbidden by law, not because they are disruptive to the efficient operation of the economy, but because there is something morally wrong with them. The case of disclosure regulation demonstrates that the institutionalized formal structures noted by Meyer and Rowan can arise from considerations other than those normally accounted for by research on efficiency, credible commitment, transaction costs, and other aspects of market rationality. I have tried to show that the formal regulations governing financial disclosure by publicly traded firms did not always arise and evolve out of a deliberate effort to provide market actors with increased information with which to effect more rational decisions, but sometimes also from a motivation to reinforce moral behavior on the part of firms and market insiders.

It is not my intention to argue that institutions do not affect instrumental concerns such as transaction costs. As North (1990) suggests, institutionalization changes relative costs. Instead, it has been my purpose to first demonstrate that a change in meaning took place over the history of this institution, and then use that fact to frame a discussion about the causal effect that formal codification of a previously informal norm has had on its meaning and application. Is it the case that as a norm is adopted into formal law, it is necessarily transformed in an instrumentally rational direction so that actors no longer orient themselves to the moral meaning that gave rise to the norm in the first place? The state cannot simply dictate that people should act morally; instead, it must provide tangible examples of what is and is not acceptable, and this has the effect of changing the relative costs of the behaviors in question. Examples of this can be seen outside the context of securities market regulation. For example, did the passing of civil rights legislation stimulate more people to recognize that racism was wrong or did it just impose penalties for violating hiring practices? If so, does this indicate a causal significance for the process of institutionalization in changing the meaning of the norm enforced? The procedural questions, I conclude from this argument, deserve to be addresses.

When norms are formalized they may become instruments through which relative prices are partly determined. This formalization may then change how actors behavior because the meaning of the norm changes somewhat as a result of this formalization. In the case of disclosure regulations, what began as an effort to reinforce morality became to some extent an instrumental, rational consideration for publicly traded firms as a result of its formalization. Firms now also orient their actions not positively toward behaving in a moral fashion, but negatively as they seek to avoid the penalties prescribed by the state. In the case of disclosure regulation, we discern a mid-point between these two states, as the state is forced to formalize into legislation the underlying informal norms, creating a tension between the symbolic nature of the stimulus (calls for morality as an opposition to corporate power) and the instrumental nature of the formal rule (requiring disclosure of material information). This tension is exacerbated by the fact that the state was legislating into a market structure that, although it was operating in a manner abusive to many and damaging a public good, the market itself was vital to the public interest and therefore necessary to protect from any additional harm, no matter the intentions of the source of that harm.

To conclude, understanding the process through which transparency came to be institutionalized contributes much to our understanding of how this aspect of U.S. securities market regulation emphasizes different outcomes over the course of its development. Understanding how the state and private actors emphasize these different meanings in the years before disclosure regulation was adopted, at the time of adoption, and in the years following adoption contributes to our understanding of the institution itself. This understanding contributes more generally to our understanding the concept of the institution, as it is addressed in the social science literature.

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