FINANCE WITHOUT GOVERNMENT: FINANCIAL REGULATION IN AN AGE OF POLITICAL UNREST

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INTRODUCTION

This Article explores the U.S. financial system from the perspective of the turmoil and dysfunction that currently characterizes the U.S. political and economic landscape. Here, I observe that there is an important, surprising, and unexamined gulf between the robust strength of U.S. capital and financial markets and the deteriorating condition of the U.S. political system. Notwithstanding a strong consensus among political scientists and economists that political instability is "a serious malaise harmful to economic performance,"[1] the U.S. financial system appears to be largely immune from the damage that one might expect to result from the recent political instability in the U.S.

From the perspective of considering the future of financial regulation in the U.S., the basic insight is that structural components of the U.S. regulatory system, particularly the independent central bank, the provision of corporate law and corporate governance rules at the state rather than the federal level, the independent judiciary and its protection of free speech have worked well to insulate the capital markets from the recent political turmoil. While the growth of regulation of financial markets likely will continue unabated, such regulation is and will continue to be, largely irrelevant in a macro sense. The analysis here is consistent with previous work in which I have posited that markets have responded to governmental failings by crafting a libertarian path forward that does not rely on regulators, Congress, or the executive to provide solutions to problems.[2]

There seems to be little doubt that government dysfunction should affect fundamental financial and economic issues like corporate governance and capital markets regulation. Increasingly, political science professors and corporate governance experts have pointed to "interference with electoral processes, disruptions to orderly transitions of power, deterioration of checks and balances across branches of government, and/or the erosion of the rule

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1 Ari Aisen & Francisco Jose Veiga, *How Does Political Instability Affect Economic Growth?*, 3 (International Monetary Fund Working Paper No. 11/12, 2011).

2 Jonathan Macey, *ESG Investing: Why Here? Why Now?,* 19 BERKELEY BUS. L. J. 258 (2022).

of law"[3] and argued that these threats to democracy "pose financial and economic risks for investors."[4] These concerns are hardly surprising because it is widely accepted that political risk, which is the risk that government activities, faulty governors, and a poor legal and institutional environment will negatively affect the profitability of businesses and the value of financial assets in an economy,[5] is a topic of acute concern to international managers.[6]

The problem this Article confronts is that the theory does not hold true. The massive political dysfunction in the U.S. appears to have virtually no discernible effect on capital markets or financial stability. Surprisingly, capital markets appear to have insulated themselves from political turmoil. As discussed below, even when the well-regarded credit rating agency Fitch lowered the long-term rating of U.S. government debt to AA+ from its previous top grade of AAA, largely due to "governance problems," the move was "widely dismissed as meaningless."[7] For better or worse, it appears that private sector capital markets have untethered themselves from politics and government.

POLITICAL TURMOIL

A recent White Paper by the United States Democracy Center and the Brookings Institution flatly asserts that "[t]hreats to democracy in the United States pose a risk to investors and the economy."[8] Layna Mosley, a Princeton professor of Politics and International Affairs, believes that the threat to capital markets from threats to democracy from election deniers and insurrectionists is so significant that "[i]nstitutional investors have a fiduciary duty to not only monitor but also respond to threats to democratic institutions in the U.S., just as they would do for other countries. These threats include the

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3 *New Survey: Institutional Investors Believe American Democracy Is Increasingly at Risk*, STATES UNITED DEMOCRACY CTR., (Aug. 23, 2023), https://statesuniteddemocracy.org/resources/new-survey-institutional-investors/.

4 *Threats to Democracy in the U.S. Pose Financial and Economic Risks for Investors*, STATES UNITED DEMOCRACY CTR., (July 11, 2023), https://statesuniteddemocracy.org/new-report-threats-to-democracy-in-the-u-s-pose-financial-and-economic-risks-for-investors/.

5 Geert Bekaert et al., *Political Risk Spreads*, 45 J. INT. BUS. STUD. 471 (2014); Stephen Davis, *Financial Implications of Rising Political Risk in the U.S.*, HARV. L. SCH. F. ON CORP. GOVERNANCE, (Sept. 15, 2023), https://corpgov.law.harvard.edu/2023/09/15/financial-implications-of-rising-political-risk-in-the-us/; Adel Al Khattab et al., *Managerial Perceptions of Political Risk in International Projects*, 25 INT'L J. PROJECT MGMT. 734 (2007); Ephraim Clark, *Valuing Political Risk*, 16 J. INT'L MONEY & FINANCE 477 (1997).

6 Mehdi Janbaz et al., *Political Risk in Banks: A Review and Agenda*, 62, RSCH. IN INT'L BUS. AND FIN. (2022) (political risk is "a critical factor in the corporate sector").

7 Greg Ip, *Why Fitch's Downgrade Matters*, WALL ST. J., (Aug. 9, 2003), https://www.wsj.com/articles/fitch-downgrade-us-credit-rating-4ad98230.

8 STATES UNITED DEMOCRACY CTR., *supra* note 3.

risks that election deniers pose."[9] Alarmingly, "thirty-three percent of election-denying candidates (15 out of 46 in the general election) prevailed in their statewide races" for governor, attorney general and secretary of state, and eight election deniers who were not up for re-election in 2022 remain in office.[10] Looking at candidates for the House of Representatives and Senate, along with state legislative candidates, 226 election deniers, or about 66 percent of those running for office, prevailed in their election contests.[11] Election deniers have important positions in many state legislatures, and many members of the Republican party majority in the U.S. House of Representatives are election deniers.[12] This provides strong evidence that "the erosion of democratic practices and norms remains a serious threat in the United States."[13]

The general consensus is that political instability should be a source of deep concern to the financial markets. As one commentator observed: "If global investors suddenly develop suspicions about the U.S. political system, that it's not stable, they will stop buying our debt. So, U.S. interest rates will go up. Mortgage rates will go up. . . . When interest rates go up, it's not good for the stock market. So people's 401(k)s will go down. . . . There are a lot of really ugly scenarios that could unfold."[14]

The highly plausible notion that threats to democracy are a problem for the financial system received substantial support on August 1, 2023, when Fitch Ratings downgraded the United States' Long-Term Foreign Currency Issuer Default Rating (IDR) to AA+ from AAA.[15] In explaining its rating downgrade, Fitch observed: "The rating downgrade of the United States reflects the expected fiscal deterioration over the next three years, a high and growing general government debt burden, and the erosion of governance relative to 'AA' and 'AAA' rated peers over the last two decades that has manifested in repeated debt limit standoffs and last-minute resolutions."[16]

Fitch specifically identified "erosion of governance" among the factors influencing the Company's decision to downgrade U.S. debt; in fact:

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9 Layna Mosley, *The Financial and Economic Dangers of Democratic Backsliding*, 3 STATES UNITED DEMOCRACY CTR. (July 2023), https://statesuniteddemocracy.org/wp-content/uploads/2023/07/THE-FINANCIAL.pdf.

10 *Id.* at 1.

11 *Id.*

12 *Id.*

13 *Id.*

14 David Lynch, *Stocks Drive Higher, Brushing Aside Worries About U.S. Stability: Capital Violence and the Threat of More to Come, Don't Faze Investors*, WASH. POST (Jan. 14, 2021), https://www.washingtonpost.com/business/2021/01/14/stocks-capitol-riot/.

15 *Fitch Downgrades the United States' Long-Term Ratings to 'AA+' from 'AAA'; Outlook Stable, Rating Action Commentary*, FITCH RATINGS (Aug. 1, 2023), https://www.fitchratings.com/research/sovereigns/fitch-downgrades-united-states-long-term-ratings-to-aa-from-aaa-outlook-stable-01-08-2023.

16 *Id.*

> In Fitch's view, there has been a steady deterioration in standards of governance over the last 20 years, including on fiscal and debt matters, notwithstanding the June bipartisan agreement to suspend the debt limit until January 2025. The repeated debt-limit political standoffs and last-minute resolutions have eroded confidence in fiscal management. In addition, the government lacks a medium-term fiscal framework, unlike most peers, and has a complex budgeting process. These factors, along with several economic shocks as well as tax cuts and new spending initiatives, have contributed to successive debt increases over the last decade. Additionally, there has been only limited progress in tackling medium-term challenges related to rising social security and Medicare costs due to an aging population.[17]

The timing of the Fitch downgrade, which some observers described as "strange,"[18] indicates that the downgrade likely was attributable to the deteriorating political landscape in the U.S. rather than to economic factors. The downgrade was characterized as strange because it came at a time when "the United States was actually improving on all the metrics that Fitch set out in its ratings watch last year. The national debt has fallen relative to the gross domestic product (GDP). The U.S. economy has avoided a recession even as inflation rates have come down. President Joe Biden and Speaker of the House Kevin McCarthy reached an agreement to suspend the debt ceiling in June [2023]."[19] At the time of the downgrade, the S&P 500 was up 18 percent on the year and had not had a down day of 1 percent or more in 47 straight sessions, the longest streak of "calm days" since January 2020.[20]

There is ample support for the proposition that the political turmoil in the United States is a problem for capital markets. Harvard Business School Professor Rebecca Henderson described what she characterized as "the decline of democracy" as a "mortal threat to the legitimacy and health of capitalism."[21] She argues, "American business needs American democracy. Free markets cannot survive without the support of the kind of capable, accountable government that can set the rules of the game that keep markets genuinely free and fair. And only democracy can ensure that governments are held accountable, that they are viewed as legitimate, and that they don't devolve into the rule of the many by the few and the kind of crony capitalism that we see emerging in so many parts of the world."[22]

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17 *Id.*

18 Brad W. Setser, *Does Fitch's Downgrade of U.S. Debt Really Matter?*, COUNCIL ON FOREIGN RELS. (Aug. 16, 2023), https://www.cfr.org/article/does-fitchs-downgrade-us-debt-really-matter.

19 *Id.*

20 Sagarika Jaisinghani & Julien Ponthus, *What Analysts Say About US Credit Downgrade by Fitch*, BLOOMBERG (Aug. 1, 2023), https://www.bloomberg.com/news/articles/2023-08-02/dollar-s-drop-on-fitch-downgrade-unlikely-to-persist-analysts.

21 Rebecca M. Henderson, *Building a Strong Democracy: Q&A with Professor Rebecca Henderson,* HARV. BUS. SCH. (Sept. 1, 2020), https://www.alumni.hbs.edu/stories/Pages/story-bulletin.aspx?num=7625.

22 Rebecca Henderson, *Business Can't Take Democracy for Granted*, HARV. BUS. REV. (Jan. 8, 2021), https://hbr.org/2021/01/business-cant-take-democracy-for-granted.

The problem appears to be more serious even than concerns about the orderly transition of power in the executive branch and the January 6, 2021, insurrection. Henderson reports survey data showing that fifty-five percent of Americans say that their democracy is "weak," with 8% claiming that it is growing weaker. Approximately one-half of respondents agreed with the statement that America is in "real danger of becoming a nondemocratic, authoritarian country." Perhaps worst of all, 70% of Americans expressed the view that "[o]ur political system seems to only be working for the insiders with money and power, and two-thirds of Americans aged 18-29 have "more fear than hope about the future of democracy in America."[23]

In 2021, the Stockholm-based International Institute for Democracy and Electoral Assistance added the United States to its list of "backsliding democracies," observing that "significantly, the United States, the bastion of global democracy, fell victim to authoritarian tendencies itself and was knocked down a significant number of steps on the democratic scale."[24] The Report observed: "A historic turning point came in 2020–2021 when former President Donald Trump questioned the legitimacy of the 2020 election results in the United States. Baseless allegations of electoral fraud and related disinformation undermined fundamental trust in the electoral process, which culminated in the storming of the US Capitol building in January 2021."[25]

Significantly, from the perspective of evaluating the effects of the events of 2020-2021 on the stability of U.S. democracy, the Institute observed that arguments similar, and equally baseless, to the ones Trump made to undermine the election, were used to justify a political coup in newly democratic Myanmar in February 2021, and to challenge election results in Peru, Mexico, and Brazil.[26] As the Washington Post observed:

> Former president Donald Trump's effort to undermine the legitimacy of the 2020 presidential election, a campaign that culminated in the Jan. 6 insurrection at the U.S. Capitol one year ago, looms large in these assessments. Many — including top military officers — feared a coup on U.S. soil. Some experts consider the insurrection itself to have been an attempted coup. Since then, some Trump allies, including former national security adviser Michael Flynn, have openly embraced the idea of a military takeover, and high-

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23 Rebecca Henderson, *The Business Case for Saving Democracy*, HARV. BUS. REV. (Mar. 10, 2020), https://hbr.org/2020/03/the-business-case-for-saving-democracy.

24 International Institute for Democracy and Electoral Assistance, THE GLOBAL STATE OF DEMOCRACY 2021 iii (2021), https://www.idea.int/democracytracker/sites/default/files/2022-11/GSOD21.pdf [hereinafter IIDEA].

25 *Id.* at 15; *see also* Press Release, Org. for Security and Co-Operation in Europe, Highly Competitive Elections in US Tarnished by Legal Uncertainty and Unprecedented Attempts to Undermine Public Trust, International Observers Say (Nov. 4, 2020), https://www.osce.org/odihr/elections/usa/469440 (on file with the OSCE Office for Democratic Institutions and Human Rights, Washington D.C.).

26 IIDEA, *supra* note 24, at 5.

> profile political observers now argue that U.S. democracy is deep into a constitutional crisis and that the "next coup has already begun."[27]

Professional investors appear to share these concerns about the future of democracy, particularly when those threats concern countries outside of the United States. A stunning 90 percent of large institutional investors surveyed by the United States Democracy Center and the Brookings Institution believe "threats to American democracy are rising."[28] While concerns about political risk appear to be growing, institutional investors remain more concerned with political risk outside of the U.S. than inside the U.S.[29] Corporate governance commentator Stephen Davis has described the survey results showing concern for political risk outside of the U.S. but not inside the U.S. as revealing "striking anomalies."[30]

In principle, the link between political stability and capital market stability seems clear and obvious. The problem might appear to be particularly acute in the U.S. because President Donald Trump, the foremost instigator of the current rise in political instability, has expressed a strong willingness to sacrifice economic stability for his own political purposes. This became clear in mid-September 2023 when Trump urged members of the Republican party in Congress to shut down the government in order to starve the federal prosecutors investigating his fraud and election interference of funds necessary to continue their work.[31] Trump asserted on his Truth Social media site that "Republicans in Congress can and must defund all aspects of Crooked Joe Biden's weaponized Government," calling it "the last chance to defund these political prosecutions against me and other Patriots."[32]

What seems most remarkable, however, is how little impact recent political turmoil and governmental dysfunction has had on U.S. capital markets and the U.S. economy. Even Fitch's downgrade of U.S. government debt

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27 Noam Lupu, Luke Plutowski & Elizabeth Zechmeister, *Would Americans Ever Support a Coup? 40 Percent Now Say Yes*, WASH. POST, (Jan. 6, 2022), https://www.washingtonpost.com/politics/2022/01/06/us-coup-republican-support/.

28 STATES UNITED DEMOCRACY CTR., *supra* note 3.

29 *Id.*

30 Stephen Davis, *Financial Implications of Rising Political Risk in the US*, HARV. L. SCH. F. ON CORP. GOVERNANCE, (Sept. 15, 2023), https://corpgov.law.harvard.edu/2023/09/15/financial-implications-of-rising-political-risk-in-the-us.

31 Susan Heavey & Doina Chiacu, *Trump Urges Government Shutdown in Unlikely Bid to 'Defund' His Criminal Prosecutions*, REUTERS (Sept. 21, 2023), https://www.reuters.com/world/us/trump-urges-government-shutdown-unlikely-bid-defund-his-criminal-prosecutions-2023-09-21/; Sarah Fortinsky, *Trump: Funding Deadline 'Last Chance' To Defund 'Political Prosecutions Against Me,'* THE HILL (Sept. 21, 2023), https://thehill.com/homenews/house/4215839-trump-funding-deadline-last-chance-to-defund-political-prosecutions-against-me-strong.

32 Fortinsky, *supra* note 31.

"was met with what amounts to a shrug" by capital markets participants.[33] Market participants at banks and hedge funds described any negative impact as "short and shallow"[34] and they characterized the event as a "tempest in a teapot."[35]

The basic point here is that Donald Trump's efforts to nullify the results of the 2020 presidential election—including the January 6 attack on the Capitol, the personal calls and threats to state officials such as Georgia Secretary of State, Brad Raffensperger, and the attempts to create and submit fraudulent certificates of ascertainment submitted by "fake electors" who would falsely claim that Trump had won the Electoral College vote—have had surprisingly little effect on capital markets. In this context, a study by John Stephens, Seyed Mehdian, Stefan Ghergina, and Ovidu Stoica of the reaction of the financial markets to the January 6 Capitol attack is particularly relevant.[36]

In this study, the authors characterize the January 6 attack as "an unexpected political event,"[37] and uses event study methodology to study the aggregate reactions, on a minute-by-minute basis of the U.S. stock markets and the more international cryptocurrency markets, as reflected in the Dow Jones Industrial Average index, the Nasdaq 100 index, the S&P 500 index and the price of Bitcoin, the most prominent cryptocurrency during the period 9:00 a.m. to 4:00 p.m. on January 6.[38] The authors found that immediately after the attack on the Capitol, "the value of Bitcoin and the indices took a slightly declining turn."[39] This decline, however, was not statistically significant, which indicates that "while the January 6 attack on the U.S. Capitol may have political importance . . . it lacks substantial financial implications."[40] Consistent with this analysis, stock watchers observed that stock markets "seem impervious to . . . the erosion of American democracy" illustrated by the "shocking events [of January 6] when an American president incited a mob to confront lawmakers preparing to certify his electoral defeat.[41] In fact, the Dow Jones Industrial Average, which had risen by sixty-seven percent since the pandemic, rose to 31,000 on January 7, the day after the Capitol riot.[42] In fact, all three leading indices, which includes the S&P 500 as well as the

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33 Sagarika Jaisinghani & Julien Ponthus, *What Analysts Say About US Credit Downgrade by Fitch*, BLOOMBERG (Aug. 1, 2023), https://www.bloomberg.com/news/articles/2023-08-02/dollar-s-drop-on-fitch-downgrade-unlikely-to-persist-analysts.

34 *Id.*

35 *Id.*

36 John Stephens, et al., *The Reaction of the Financial Market to the January 6 United States Capitol Attack: An Intraday Study*, 56 FIN. RSCH. LETTERS 104048 (2023).

37 *Id.*

38 *Id.*

39 *Id.*

40 *Id.*

41 David Lynch, *Stocks Drive Higher, Brushing Aside Worries About U.S. Stability*, WASH. POST (Jan. 14, 2021, 6:00 AM), https://www.washingtonpost.com/business/2021/01/14/stocks-capitol-riot/.

42 *Id.*

Nasdaq Stock Market, rose as the riot was unfolding,[43] leading to headlines like "Wall Street's reaction to Washington mayhem? All-time highs."[44]

Observing the volatility of financial markets during the January 6 insurrection is another way of gaining insight into the economic effects of recent political turmoil. Previous research has found that political unpredictability leads to higher volatility in stock prices.[45] A standard measure of stock market volatility is the CBOE Volatility Index, known as the VIX, which measures the implied volatility of the S&P 500. Implied volatility is a forward-looking metric used by options traders that measures future volatility as reflected in options premiums through the use of the Black-Scholes options pricing model. The VIX is often referred to as the market's "fear gauge," and is "used by investors to measure market risk, fear and stress."[46] In general, VIX values of greater than thirty are considered to signal heightened volatility from increased uncertainty, risk and investor fear. VIX values below twenty generally correspond to more stable, less stressful periods in the markets.[47] As shown in the table below,[48] stock market volatility was in line with previous days and not abnormal. Moreover, market volatility has declined since the attack, falling below twenty at the end of March 2023 and remaining so until the time of this writing, September 22, 2023, when the VIX at the close was 17.20.[49]

Stock Market Volatility Around the January 6, 2021, Attack on the Capitol				
Date	VIX (open)	VIX (high)	VIX (low)	VIX (close)
December 31, 2020	22.99	23.25	21.24	22.75
January 4, 2021	23.04	29.19	22.56	26.97
January 5, 2021	26.94	28.60	24.80	25.34

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43 Stephen Gandel, *Wall Street's Reaction to Washington Mayhem? All-time Highs*, CBS NEWS (Jan. 7, 2021, 6:21 PM), https://www.cbsnews.com/news/stock-market-united-states-capitol-breach-january-7/.

44 *Id.*

45 John W. Goodell & Sami Vähämaa, *US Presidential Elections and Implied Volatility: The Role of Political Uncertainty*, 37 J. BANK FIN. 1108 (2013).

46 *VIX: What You Should Know About the Volatility Index*, FIDELITY INT'L, https://www.fidelity.com.sg/beginners/what-is-volatility/volatility-index (last visited Mar. 28, 2024).

47 *Id.*

48 *CBOE Volatility Index (VOX)*, YAHOO FIN., https://finance.yahoo.com/quote/%5EVIX/history?period1=1609372800&period2=1610409600&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true (last visited Mar. 28, 2024).

49 *Id.*

January 6, 2021	25.48	26.77	22.14	25.07
January 7, 2021	23.67	23.91	22.25	22.37
January 8, 2021	22.43	23.34	21.42	21.56
January 11, 2021	23.31	24.81	23.23	24.08
January 12, 2021	23.49	25.15	22.83	23.33

Another measure of the continued vibrancy of U.S. financial markets in the face of political turmoil is the continued ability of companies to raise capital in the public equity markets through initial public offerings ("IPOs") of their securities. This measure seems particularly relevant because the ability of firms to obtain external financing in the capital markets appears to depend critically on the quality of the legal environment in the market in which the securities are issued.[50] The number of initial public offerings rose from 232 in 2019 to 480 in 2020, and then to a remarkable 1,035 in 2021.[51]

Another measure of the response of U.S. financial markets to the recent political turmoil and threats to democracy poised by election deniers is foreign direct investment into the United States. If the January 6 riots and the efforts to overturn the U.S. election were undermining confidence in the U.S. as a place to do business, then one might expect foreign direct investment into the United States to have declined during 2021, the year in which the riots occurred. Foreign direct investment is a category of cross-border investment in which an investor resident in one economy "establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy. Ownership of ten percent or more of the voting power in an enterprise in one economy by an investor in another economy is evidence

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50 Rafael La Porta, et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1149 (1997).

51 *Number of IPOs in the United States from 1999 to 2022*, STATISTA, https://www.statista.com/statistics/270290/number-of-ipos-in-the-us-since-1999 (last visited Mar. 28, 2024). A more conservative tabulation of IPOs has been prepared by Jay Ritter. His statistics exclude ADRs, natural resource limited partnerships and trusts, closed-end funds, REITs, SPACs, banks and S&Ls, unit offers, penny stocks (offer price of less than $5 per share), and stocks not listed on Nasdaq or the NYSE (including NYSE MKT LLC, the former American Stock Exchange). This tabulation shows IPOs strong during the relevant period, with IPOs increasing to 165 in 2020 from 113 in 2019. IPOs in 2021 increased to 311 from the 2020 estimate of 165. Jay Ritter, *Initial Public Offerings: Updated Statistics*, UNIV. OF FL. WARRINGTON COLL. OF BUS. (Sept. 20, 2023), https://site.warrington.ufl.edu/ritter/ipo-data/. Yet another tabulation, this one by the accounting firm EY, listed 168 IPOs in 2019, 224 in 2020, and 416 in 2021. Rachel Gerring & Mark Schwartz, *IPO Activity Still Slow in 1H 2023, But Market Conditions Are Improving*, EY (July 25, 2023), https://www.ey.com/en_us/ipo/1h-2023-ipo-market-trends.

of such a relationship."[52] It is well known, of course, that foreign direct investment contributes positively to the Gross Domestic Product ("GDP") of the host countries by bringing in foreign exchange reserves and improvement of the Balance of Payment for the economies that receive such foreign direct investment.[53]

Not surprisingly, political risk is strongly negatively correlated with foreign direct investment, even in high income countries.[54] Political uncertainty is thought to be a major determining factor of long-term economic growth, and political uncertainty is associated with decreases in GDP growth, employment, and investment and adverse effects to equity prices.[55]

Thus, it appears that the genuinely disturbing events in the United States in the wake of the 2020 election had surprisingly little effect on the capital markets. This result is surprising because it seems to run counter to the long-held hypothesis in development economics that uncertain socio-political conditions affect growth negatively.[56] Remarkably, and clearly counter to the notion that the political turmoil surrounding the 2020 election was a signal of political instability, new U.S. foreign direct investment for 2021 was $362.6 billion, a 140% increase from 2020,[57] and significantly above the annual average of $298.8 billion during the period 2014 to 2021.[58] Foreign direct investment as a percentage of GDP rose from 0.71%. in 2021 to 1.52% in 2022, the highest level since 2017.[59] In fact, the United States recorded the largest increase in foreign direct investment of all economies in 2021, with an increase of 11.3%.[60]

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52 *Foreign Direct Investment (FDI)*, ORG. FOR ECON. COOP. & DEV., https://doi.org/10.1787/9a523b18-en (last visited Mar. 28, 2024); *see also* Maitena Duce, *Definitions of Foreign Direct Investment (FDI): A Methodological Note*, BANK FOR INT'L SETTLEMENTS, July 31, 2003, at 2–3.

53 E. Borensztein et al., *How Does Foreign Direct Investment Affect Economic Growth?*, 45 J. INT'L ECON. 115 (1998).

54 Mashrur Mustaque Khan & Mashfique Ibne Akbar, *The Impact of Political Risk on Foreign Direct Investment*, 5 INT'L J. ECON. & FIN. 147, 151–52 (2013).

55 Wonseok Choi, et al., *Firm-level Political Risk and Corporate Investment*, 46 FIN. RSCH. LETTERS 102307 (2022).

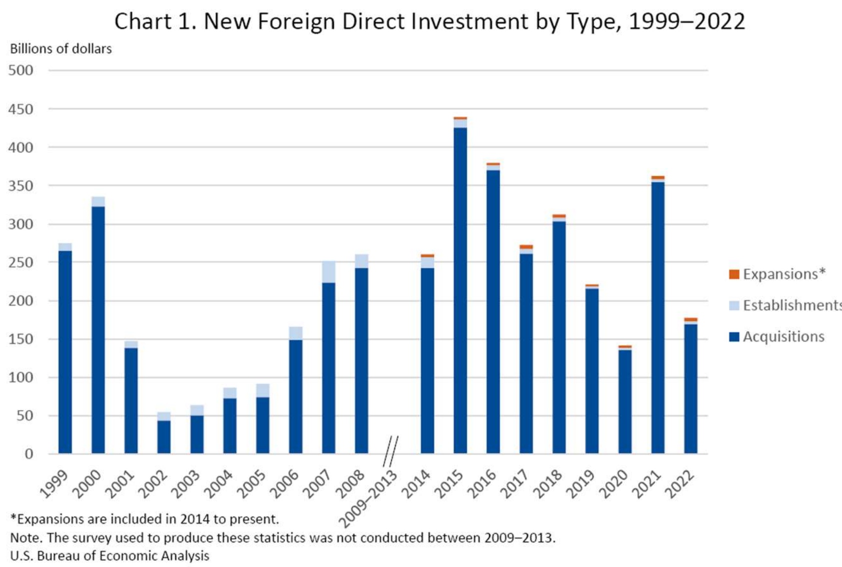
56 Robert Barro, *Economic Growth in a Cross-Section of Countries*, 106 QUARTERLY J. ECON. 407, 432 (1991); Alberto Alesina & Roberto Perotti, *Income Distribution, Political Instability and Investment*, 40 EUR. ECON. REV. 1203 (1996); Dimitrios Asteriou & Costas Siriopoulos, *The Role of Political Instability in Stock Market Development and Economic Growth: The Case of Greece*, 29 ECON. NOTES BY BANCA MONTE DEI PASCHI DI SIENA SPA 355, 356 (2000).

57 *New Foreign Direct Investment in the U.S., 2022*, BUREAU OF ECON. AFF., July 10, 2023. The survey used to produce the statistics was not conducted between 2009 and 2013.

58 *Id.*

59 *United States Foreign Direct Investment, Net Inflows (% Of GDP)*, TRADING ECON., https://tradingeconomics.com/united-states/foreign-direct-investment-net-inflows-percent-of-gdp-wb-data.html (last visited Mar. 28, 2024).

60 Jannick Damgaard & Carlos Sánchez-Muñoz, *United States Is World's Top Destination for Foreign Direct Investment*, INT'L MONETARY FUND BLOG (Dec. 7, 2022), https://www.imf.org/en/Blogs/Articles/2022/12/07/united-states-is-worlds-top-destination-for-foreign-direct-investment.



CONSTITUTIONAL STRUCTURE AND DESIGN

The most likely explanation for why the recent political instability has had so little effect on capital markets is the presence of three critical structural features of the U.S. political system: the independent federal judiciary, the independent Federal Reserve, and the continuing power of the state over fundamental rules of corporate law and corporate governance. These key components of economic regulation operate at a relatively safe distance from the partisan politics of Congress and the executive and have been largely (though not entirely) unaffected by Trumpian threats to democracy.

It is well understood that well-designed institutions can improve economic performance,[61] and the continued smooth functioning of U.S. capital markets in the wake of Trump-era political turmoil provides strong additional support for this basic proposition.

THE FEDERAL JUDICIARY

It is well-known that the U.S. judicial system responded relatively well to the recent political upheaval and anti-democratic initiatives. As William Galston and Elaine Kamarack have observed:

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61 Jan Elster, *The Impact of Constitutions on Economic Performance*, 8 WORLD BANK ECON. REV. 209 (1994).

> under assault from then-President Trump, the judiciary remained independent despite his repeated attempts to win in the courts what he could not win at the ballot box. President Trump-appointed judges often made decisions that thwarted Mr. Trump's attempts to overturn the results. In fact, after the election Mr. Trump's team and allies brought 62 lawsuits and won exactly one. (The others he either dropped or lost.) Many of those decisions were handed down by Republican judges. Perhaps former President Trump's biggest disappointment was the Supreme Court's decision not to hear election challenges concerning states he claimed he had won.[62]

Interestingly, it appears that, while Trump and his co-defendants fared slightly better at the state and local level than they did at the federal level, they still only persuaded eighteen percent of the total number of judges in their cases at the state and local level.[63]

In addition to denying spurious attempts to overturn legitimate election results, the independent federal judiciary protects democracy, and in so doing, provides the political stability required to maintain well-functioning capital markets. Protection of the right to freedom of speech guaranteed in the First Amendment, which the courts faithfully protect, is a related factor in mitigating the negative economic effects of Trump's anti-democratic machinations.[64]

Freedom of speech is critical to the operation of capital markets because it protects (perhaps too well) those who criticize government policies, including government policies that undermine capital markets. As Harry Kalven argued, the freedom of speech guaranteed by the First Amendment is tantamount to a protection of autonomy.[65] Or, as Owen Fiss maintained, the purpose of free speech is not "individual self-actualization, but rather the preservation of democracy and the right of a people to decide what kind of life it wishes to live."[66] Amartya Sen famously observed that no substantial famine has ever occurred in a country with a free press.[67] Sen observed that the

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62 William A. Galston & Elaine Kamarack, *Is Democracy Failing and Putting Our Economic System at Risk?*, BROOKINGS (Jan. 4, 2022), https://www.brookings.edu/articles/is-democracy-failing-and-putting-our-economic-system-at-risk; *see also* William Cummings, et al., *By the Numbers: President Donald Trump's Failed Efforts to Overturn the Election*, USA TODAY (Jan. 6, 2021, 5:01 AM), https://www.usatoday.com/in-depth/news/politics/elections/2021/01/06/trumps-failed-efforts-overturn-election-numbers/4130307001; Alanna Durkin Richer, *Trump Loves to Win But Keeps Losing Election Lawsuits*, ASSOCIATED PRESS (Dec. 4, 2020, 8:04 PM), https://apnews.com/article/donald-trump-losing-election-lawsuits-36d113484ac0946fa5f0614deb7de15e.

63 Russell Wheeler, *Trump's Judicial Campaign to Upend the 2020 Election: A Failure, But Not a Wipe-out*, BROOKINGS (Nov. 30, 2021), https://www.brookings.edu/blog/fixgov/2021/11/30/trumps-judicial-campaign-to-upend-the-2020-election-a-failure-but-not-a-wipe-out/.

64 Owen Fiss, *Free Speech and Social Structure*, 71 IOWA L. REV. 1405, 1405 (1986) (the Supreme Court has nurtured the principle of freedom of speech and "given it much of its present shape, and accounts for much of its energy and sweep").

65 *See generally* Harry Kalven, *The New York Times Case: A Note on "The Central Meaning of the First Amendment"*, 1964 SUP. CT. REV. 191 (1964).

66 Fiss, *supra* note 64, at 1409–10.

67 Frances D'Souza, *Democracy as a Cure for Famine*, 31 J. PEACE RSCH. 369, 369 (1994) (*citing* Amartya Sen, *Liberty and Poverty: Political Rights and Economics*, 210 THE NEW REPUBLIC 31, 31–37 (1994)).

information disseminated by a free press creates strong incentives for politicians to address problems that are likely to galvanize voters to demand change. In addition, the information generated by a free press provides information to the highest levels of government that lower level officials may hide from them for fear of challenging the prevailing popular myths favored by incumbent politicians at the top. Frances D'Souza illustrates the power of freedom of the press in avoiding economic disaster with a story about the famine of 1959-1961 in China:

> The famine of 1959-61 was a direct result of the withholding of information at all levels of Chinese bureaucracy. Moreover, the active censorship and disinformation prevented effective famine relief once the disaster had begun, and certainly prolonged the effects by concealing the gravity of the problem. It was not so much people in the cities and larger towns who suffered but the rural poor who were decimated, village by village. And yet, at the height of the famine, peasants did not dare even speak about the deaths of family members for fear of challenging the prevailing myth of economic miracle and food abundance. It cannot be known whether the leaders actually believed assurances that agricultural production was about to surpass that of the previous bumper year: what was important was that the myth was perpetrated and sustained through fear and censorship. This served as a wholly effective barrier to accurate information and therefore to any relief action. The complex and rigid levels of bureaucracy, governed by Mao Zedong at the pinnacle and ruled by corruption and terror, encouraged the cadres at the commune and county level to exaggerate agricultural production because they were asked to do so by the level of bureaucracy above them, the district cadres and so on, right up to the top. Peasants at the communal level were obliged to wildly exaggerate the harvest estimate through fear of punishment; these wild estimates were further exaggerated at each level of bureaucracy, yielding a grossly distorted figure which precluded any accurate information or knowledge about the dearth of grain at the rural level.[68]

It is well known that President Trump regularly attacked the free speech throughout his presidency.[69] During Trump's first 100 days in office, the writer's free speech advocacy organization PEN America catalogued 70 separate instances of attacks on the press by Trump or senior Administration officials, including describing the press as "the enemy of the people."[70] As PEN America observed, there were "near-daily efforts by the Trump Administration to undermine the press during the President's first 100 days. Such efforts not only chip away at public trust for the media and its indispensable role in keeping the public informed, but also signal to regimes abroad that the United States will not stand up for press freedom."[71] No court, however, showed any proclivity for limiting First Amendment speech protections.

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68 *Id.* at 371.

69 James Tager, *Trump the Truth: Free Expression in the President's First 100 Days*, PEN AM. (Apr. 27, 2017), https://pen.org/research-resources/trump-the-truth/.

70 *Id.*

71 *Id.*

THE FEDERAL RESERVE

The political turmoil that led to the downgrade of the U.S. credit rating did not have a significant effect on U.S. capital markets because the downgrade was not viewed as changing the Fed policy in general and Fed policy towards interest rates in particular.[72] The Fed's policy on interest rates was expected to "continue to be guided by incoming economic data such as non-farm payrolls (NFP) . . . and the Consumer Price Index"[73] as a measure of inflation.

Over the past 50 years or so, a clear consensus has emerged that granting central banks independence so that they can conduct monetary policy free from political pressure from elected officials produces positive economic outcomes because the independence allows them to resist pressure to exploit short-term trade-offs between inflation and employment.[74]

During Donald Trump's term as President, he continually attempted to undermine the independence of the Fed. He has been characterized as being "voracious in his frequent attacks on Fed policy."[75] Trump was particularly aggressive in his criticism of Federal Reserve Chair, Jerome Powell, whom he described as a "golfer who can't putt," and as a "bigger enemy" to the United States than Chinese President, Xi Jinping.[76]

As officials of the European Central Bank observed in a paper on central bank independence, while in office President Trump:

> repeatedly threatened to remove the Fed's Chair and voiced his intention to appoint close political allies and outspoken critics of the Fed to two seats of the central bank's Board. In addition, the President has publically and repeatedly called for lower interest rates and faster rate cuts in order to boost the economy and as a policy response to shocks arising

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72 *Fitch's Downgrade of the US – Interesting Timing with Muted Reaction*, FRANKLIN TEMPLETON (Aug. 2, 2023), https://www.franklintempletonme.com/articles/2023/western-asset/fitchs-downgrade-of-the-us-interesting-timing-with-muted-market-reaction.

73 *Id.*

74 Marc Labonte & Gail E. Makinen, *Central Bank Independence and Economic Performance: What Does the Evidence Show?*, CONG. RSCH. SERV. (June 6, 2007), https://crsreports.congress.gov/product/pdf/RL/RL31955/6; Tobias Adrian, *Central Bank Independence and the Development of Payments and CBDCs*, INT'L MONETARY FUND (Jan. 10, 2023), https://www.imf.org/en/News/Articles/2023/01/10/sp-central-bank-independence-development-payments-and-cbdc, ("To date, numerous studies have validated the critical importance of *independence* for monetary policies that are aimed at low and stable inflation.").

75 Thilo Kind et al., *Threatening Central Bank Independence One Tweet at a Time*, CTR. FOR ECON. POL'Y RSCH. (Jan. 25, 2020), https://cepr.org/voxeu/columns/threatening-central-bank-independence-one-tweet-time.

76 Matt Egan, *Trump's Attacks on the Fed are Moving Markets, Study Shows*, CNN BUS. (Sept. 24, 2019), https://www.cnn.com/2019/09/24/business/trump-fed-independence-twitter/index.html.

> from the country's trade disputes with China. These government interferences can put into question the Fed's degree of actual institutional and functional independence.[77]

Efforts by Trump to undermine the Fed during his term in office include, in addition to his "numerous tweets . . . calling for lower rates and questioning the Fed's decisions,"[78] his decision not to re-appoint then-Fed Chair, Janet Yellen to a second term, which "was seen by some as breaking with precedent."[79] In addition, on March 22, 2019, Trump nominated his former campaign adviser and co-author of a book on "Trumponomics" for a seat on the Fed's board.[80] The nomination "drew criticism and was ultimately withdrawn."[81] On June 18, 2019, Bloomberg published an article describing how Trump had asked lawyers about the possibility of removing Jerome Powell from his position as Chair of the Board of Governors of the Federal Reserve System.[82] Soon after, on July 2, 2019, President Trump announced his intention to nominate two new candidates for seats on the Board of Governors of the Federal Reserve System. These were the executive vice-president of the Federal Reserve Bank of St. Louis and the President's former economic advisor, who was "an outspoken critic of the central bank's powers to set interest rates and was sympathetic to the gold standard."[83] These actions prompted the issuance of a joint statement by four former Chairs of the Fed expressing support of the Fed's independence and its ability to act without the threat of removal or demotion of its leaders for political reasons.[84]

Economists Thilo Kind, Howard Kung, and Francesco Bianchi have maintained that Trump's frequent attacks on the Federal Reserve are worrisome because they have created a regulatory environment in which "market participants do not believe the Fed is truly independent."[85] These economists find some evidence that Trump influenced the conduct of monetary policy.[86]

While it appears that central bank independence may have bent a bit during the Trump presidency, it did not break. The Fed remained a stalwart opponent of inflation. Equally important, the survey evidence shows that "President Trump's repeated attacks on the Federal Reserve haven't

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77 Rodolfo Dall'Orto Mas et al., *The Case for Central Bank Independence*, 37 (ECB, Occasional Paper Series No. 248, 2020) https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op248~28bebb193a.en.pdf.

78 *Id.* at 57.

79 *Id.*

80 *Id.* at 38.

81 *Id.* at 57.

82 Kind et al., *supra* note 75; Francesco Bianchi et al., *Threats to Central Bank Independence: High-Frequency Identification with Twitter*, 6 (NBER, Working Paper No. 26308, 2022), https://www.nber.org/papers/w26308.

83 Mas et al., *supra* note 77, at 57.

84 *Id.*

85 Kind et al., *supra* note 75.

86 *Id.*

significantly damaged perceptions of the central bank's independence."[87] The survey results showed that "[s]lightly more than half of the economists surveyed said the president's criticism has had little or no effect on the central bank's perceived ability to make policy decisions independent of political pressure. Another 42% said the Fed's independence has been only modestly undermined."[88] Thus, it appears that, at least so far, the Fed remains politically independent. This continued independence is a major source of stability for financial markets and goes a long way in explaining why the political turmoil in the United States has not, so far at least, had a significant negative effect on U.S. financial markets.

THE SEPARATION OF OWNERSHIP AND CONTROL

Another significant institutional protection for U.S. capital markets lies in the fact that stock ownership in the United States is very widespread, particularly among the population of likely voters. It would be political suicide for any politician to embrace policies that threated the financial health of such a wide swathe of the population. In the spring of 2023, Gallup reported that 61 percent of U.S. adults owned stock, the highest level of stock market investing recorded since 2008.[89] In the key demographic of households earning $75,000 or more annually, stock ownership exceeded 80 percent.[90] With the exception of young adults (defined as those under 30), where only 41% of the cohort owns stock, strong majorities of all other age cohorts are invested in the stock market.[91] Unsurprisingly, stock ownership correlates most strongly with household income. More than eight in ten Americans with an annual household income of $75,000 or more own stock, including 80% of those with an income between $75,000 and $99,999 and 84% of those with an income of $100,000 or more.[92] About half of Americans in households earning between $30,000 and $74,999 own stock (51%), as do roughly one in four of those earning less than $30,000 (24%).[93]

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87 David Harrison, *President Trump's Criticism of the Fed Hasn't Shifted Perception of Its Independence, Economists Say*, WALL ST. J. (July 12, 2019), https://www.wsj.com/articles/president-trumps-criticism-of-the-fed-hasnt-shifted-perception-of-its-independence-economists-say-11562925601.

88 *Id.*

89 Jeffrey M. Jones, *U.S. Stock Ownership Highest Since 2008*, GALLUP (May 24, 2023), https://news.gallup.com/poll/506303/stock-ownership-highest-2008.aspx.

90 *Id.*

91 *Id.*

92 *Id.*

93 *Id.*

This dispersion of share ownership is important because, unsurprisingly, political instability harms stock prices.[94] In the month after Trump's unexpected election victory on November 8, 2016, the stock market experienced a five percent gain in a month.[95] The stock market continued to perform well, notwithstanding a looming trade war with China and Trump's first impeachment, at least until the coronavirus dragged the global economy down.[96] Trump was quick to take credit for the bull market, tweeting about "his success" over 150 times.[97] All in all, Trump's term in office was good for the stock market, with the S&P up 56% during the four-year period.[98] While the performance of the stock market during Trump's presidency was strong in historical terms, President Obama's was better, particularly during his first term in office. The Dow gained 72% during President Obama's first term, 14 percentage points better than it did during Trump's term, though the market during Trump's presidency outpaced the 46% rise during Obama's second term.[99]

In his bid for reelection, Trump loudly pandered for votes based on the performance of the stock market during his presidency. For example. On July 6, 2020, Trump tweeted:

> If you want your 401k's and Stocks, which are getting close to an all time high (NASDAQ is already there), to disintegrate and disappear, vote for the Radical Left Do Nothing Democrats and Corrupt Joe Biden. Massive Tax Hikes - They will make you very poor, FAST![100]

The point here is that the widespread ownership of equity, combined with voters' tendency to blame presidents for poor stock market performance, makes the president captive to the stock market. Stock market performance has been identified as "an important explanatory variable in determining the popular vote."[101] Rising stock prices have been found to "result in voters

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94 Hira Irshad, *Relationship Among Political Instability, Stock Market Returns and Stock Market Volatility*, STUD. IN BUS. & ECON., Aug. 2017, at 70, 70, https://intapi.sciendo.com/pdf/10.1515/sbe-2017-0023.

95 Noel Randewich & Saqib Iqbal Ahmed, *Trump's Stock Market: A Wild Four Years*, REUTERS (Oct. 29, 2020), https://www.reuters.com/article/us-usa-election-markets-stocks-graphic/trumps-stock-market-a-wild-four-years-idUSKBN27E1IC.

96 *Id.*

97 *Id.*

98 Ben Levisohn, *How Trump's Stock Market Performance Stacks Up*, BARRON'S (Jan. 20, 2021), https://www.barrons.com/articles/how-trumps-stock-market-performance-stacks-up-to-other-presidents-51611150990.

99 *Id.*

100 Ben Wershkul, *Here's Who Trump Likes to Blame When the Stock Market Goes Down*, YAHOO FIN. (Sept. 15, 2020), https://www.yahoo.com/video/heres-who-trump-likes-to-blame-when-the-stock-market-goes-down-152234488.html.

101 Richard F. Gleisner, *Economic Determinants of Presidential Elections, The Fair Model*, 14 POL. BEHAV. 383, 384 (1992), https://link.springer.com/article/10.1007/BF00992041.

rewarding the incumbent party candidate for the expected strong performance of the economy. Falling stock prices, on the other hand, cause voters to punish the incumbent party candidate."[102]

Widespread stock ownership makes presidents care about the performance of the stock market. Stock market performance is impacted by political stability. Thus, widespread stock ownership makes presidents care about political stability. This conclusion seems strange in the case of Donald Trump because, while Trump appears to have cared deeply about stock market performance, he does not appear to have cared much, if at all, about political stability. Perhaps the key to this puzzle lies in the fact that Trump lost the election. Trump was the first incumbent to lose a presidential election since George H.W. Bush lost in 1992. Moreover, Trump was the only president in the history of polling to have never garnered the approval of a majority of Americans.[103]

STATE LAW AND CORPORATE LAW FEDERALISM

Two distinctive features of U.S. federalism are the allocation of regulatory authority over corporate governance to the states, and the internal affairs doctrine, which is a choice of law rule that allocates to the state that issues a corporation's corporate charter virtually complete authority to regulate the relationships among the corporation and its shareholders, directors, officers and other agents.[104] As the Supreme Court has observed, "[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires . . . state law will govern the internal affairs of the corporation."[105]

A distinctive feature of U.S. corporate law is jurisdictional competition for corporate charters. States compete with one another for the business of chartering corporations and other forms of business organizations. Delaware has long dominated this jurisdictional competition, with 67.8 percent of Fortune 500 companies choosing to incorporate in Delaware.[106] A critical feature of Delaware corporate law is its stability. As Roberta Romano showed, Delaware is an attractive place for business to incorporate because the state's dependency on the significant tax revenues it receives from corporate

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102 *Id.* at 385; *see also* William A. Luksetich & William B. Riley, Jr., *The Effects of Economic Factors on Presidential Elections: 1900–1972*, 7 J. BEHAV. ECON. 11 (1978).

103 Alan Greenblatt, *Five Reasons Donald Trump Lost the Presidency*, GOVERNING (Nov. 3, 2020), https://www.governing.com/now/five-reasons-donald-trump-lost-the-presidency.html.

104 RESTATEMENT (SECOND) OF CONFLICT OF LS. § 302 cmt. a (AM. L. INST. 1971).

105 Santa Fe Industries, Inc v. Green, 430 U.S. 462, 479 (1977) (quoting Cort v. Ash, 422 U.S. 66, 84 (1975)); *see also* Business Roundtable v. SEC, 905 F.2d 406, 412 (D.C. Cir. 1990).

106 Pierluigi Matera, *Delaware's Dominance, Wyoming's Dare—Blockchain Companies and the Market for Corporate Charters*, OXFORD BUS. L. BLOG (Mar. 25, 2021), https://blogs.law.ox.ac.uk/business-law-blog/blog/2021/03/delawares-dominance-wyomings-dare-blockchain-companies-and-market.

chartering provides a strong commitment that it will act predictably and not make precipitous or unwelcome changes to the legal landscape that governs the companies chartered there.[107] Delaware laws provide an oasis of stability for American business amidst the current sea of political turmoil.

CONCLUSION

Structural and institutional features of the U.S. legal system appear, at least to date, to have insulated the financial markets from the effects of political instability and rising anti-democratic sentiment. The fact that political turmoil, which has included the January 6, 2001 attack on the Capitol and ongoing election denial has had no discernible effect on financial markets is surprising in light of the broad academic consensus that political instability damages capital markets. In this Article I identified structural and institutional features that explain this puzzle. In particular, institutions that are largely insulated from political pressure, particularly the Federal Reserve and the independent judiciary appear to be a source of strength for the financial markets. I also found that the success of federalism in carving out a distinctive role for state law in corporate governance and in fostering jurisdictional competition for corporate charters has created a system in which state courts, particularly Delaware, can be counted on to create a robust legal environment for business. Finally, I note that politicians are further constrained from acting in ways that damage financial markets by their need for political support from an electorate comprised of people with significant investments in the stock market.

107 Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 276–78 (1985) (explaining how Delaware's "commitment to firms," gives it a distinctive advantage over other states); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 9 (1993) (observing "[t]he extraordinary success of tiny Delaware in the corporate charter market due to its responsiveness to changing corporate demands."); Roberta Romano, *Market for Corporate Law Redux*, *in* 2 THE OXFORD HANDBOOK OF LAW AND ECONOMICS 358, 365 (Francesco Parisi ed., 2017) (showing that "firms changing domicile tend to move from less to more responsive states").