The purpose of this thesis is to address a fundamental question: what explains the nature and scope of the observed disclosure regulation and enforcement in securities markets? The first chapter asks the question: why is it desirable to have disclosure regulation even when sellers of the securities (firms) can credibly and voluntarily disclose information? A theoretical model is developed to show that a law that mandates disclosure of unfavorable events reduces socially excessive voluntary disclosures when the credible disclosure is costly (e.g., verification cost). Absent the optimal mandatory disclosure, firms have incentives to disclose too much because non-disclosure is perceived to be bad news. The efficient law takes the form of a threshold such that only unfavorable events are subject to mandatory disclosure. Both the voluntary and efficient mandatory disclosure increase when information is more precise, or when disclosure costs decrease. Hence, we should expect a positive association between mandatory disclosure and voluntary disclosure from a cross-sectional perspective. The threshold-type regulation is also consistent with various observed accounting standards (e.g., asset impairment).

The second chapter extends the theory in the first chapter by considering various environments in which information per se has real effects (social value). The settings considered include (i) information can facilitate optimal post-sale decision making by the buyers, (ii) information can facilitate optimal liquidation of assets, and (iii) information can prevent market break-down in a “market for lemons”. The optimality of the threshold-type regulation is robust in those settings. The model thus provides a coherent framework to understand the information environment in securities markets with various insights which are not available in models with the provision of information being exogenous or the mandatory disclosure and voluntary disclosure being considered independently.

The first two chapters examine the disclosure regulation problems while assuming away the enforcement problem (disclosure is truthful although costly). The third chapter develops a positive theory of regulatory enforcement in a multi-firm setting where enforcement and investments are jointly determined by economic fundamentals. The purpose of this theory is to explain (i) why enforcement of securities laws varies significantly across jurisdictions, and (ii) why there is a positive association between enforcement intensity and capital market development. By extending the classic problem that public agency cannot commit to any long-term policy (Kydland and Prescott, 1977) to a heterogeneous-agent setting in which entrepreneurs' private information of their heterogeneous projects serves as correlated signals of the aggregate state of the economy, the theory explains how the discretionary enforcement policy induces a coordination problem among entrepreneurs (firms) when making investment decisions. The model offers a sharp characterization of the unique equilibrium of the “global game” in which the market can be either over-sized and over-regulated or under-sized and under-regulated depending on the primitives of the financial market. In addition to contributing to the extensive literature of accounting and law enforcement, the theory also adds to the macroeconomics theory by showing a novel mechanism through which a coordination problem can arise in economic development.