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Destructive government

By Richard W. Rahn
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The basic function of government is to protect person and property, but all too often government does just the opposite. In their zeal to protect us from financial fraud, government officials recently engaged in a series of actions that have cost tens of thousands of innocent people their jobs, reduced U.S. international competitiveness, and destroyed more than $1 trillion in value for American shareholders.

Every American now suffers from the excesses of certain prosecutors and judges, and from Congress' tendency to pass legislation aimed at correcting what they perceive as problems without thinking through the consequences of their actions. In the wake of the Enron scandal, the government went after Enron's auditor, Arthur Andersen, and destroyed the company. The Supreme Court has just overturned the conviction of Arthur Andersen. The government's irresponsible attack on the company cost 28,000 innocent people their jobs and made the auditing business less competitive, which has substantially increased auditing costs for every U.S. company. That, in turn, hurts their employees, suppliers and customers.

New York Attorney General Elliott Spitzer has just suffered a defeat at the hands of a jury for trying to convict a stockbroker for noncriminal actions. Mr. Spitzer has used intimidation against a number of companies, charging them with actions that may not even be crimes. In essence, he "blackmails" them into paying large settlements under the threat of destroying their business (like Andersen), though they may be innocent of any wrongdoing. These unfairly induced, forced settlements are costly to innocent stockholders and current and potential employees.

The Securities and Exchange Commission (SEC) and other government agencies routinely penalize companies for wrongdoing, even if only a few executives engaged in illegal practices. In many such cases, the shareholders were the victims of the fraud, yet government fines further increase the shareholders' loss. This makes as much sense as if you called the police because your home had been robbed, then the government fined you because a robber came into your house. SEC Commissioner Paul Atkins has tried to stop this despicable practice, and with the impending appointment of Chris Cox as SEC chairman, he may now have the votes to do so.

The most outrageous example of the government punishing everyone for the frauds of a few bad apples was passage of the Sarbanes-Oxley Act. Peter Wallison, former U.S. Treasury general counsel and now an American Enterprise Institute resident fellow, has just published a study in which he documents the costliness of the Sarbanes-Oxley Act, with almost no discernible benefit. As Mr. Wallison correctly notes, the existing statutes against fraud and the securities laws already adequately protect us from those who engage in fraud. Sarbanes-Oxley (SOX) is a costly and misguided attempt to prevent people intent on committing fraud from doing so by substantially increasing regulation of public companies. But given there are an almost unlimited numbers of ways to engage in fraud, if one is intent on doing so, efforts to regulate the attempt will almost always fail.

SOX is a poster child for a government act whose cures are worse than the disease. Its provisions are so costly one section of the bill alone has an average company cost of $4.36 million, and the regulated companies will have to pay $6.1 billion this year alone to comply with SOX. To ensure companies comply with the regulations, the four large accounting firms that do almost all public company audits have raised their fees an average of 78 percent to 134 percent in 2004.

Professor Ivy Xiying Zhang of the University of Rochester has calculated SOX has resulted in a cumulative loss of $1.4 trillion for the shareholders of public companies. (This works out to an average loss of about $460 for every man woman and child in the United States).

Mr. Wallison goes on to demonstrate there are few discernible and quantifiable benefits to the legislation. It is also unlikely many major financial scandals would have been stopped if the legislation had been in effect; but, had they been, their cumulative costs were only a small fraction of the costs of the so-called corrective legislation SOX.

Government officials are all too slow to admit and correct their destructive laws, regulations and actions. What we need is legislation that gives citizens, associations and businesses the right to contest in court laws and regulations that do not meet a reasonable cost-benefit test. Only then will government excess and abuse be brought under control.

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