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The danger of over-regulation

It is no secret that excessive regulation, such as excessive taxation of any business or industry, can weaken or even kill it. The financial industry is particularly sensitive to excessive regulation given that capital can flow from one regulatory jurisdiction to another at almost the speed of light. Appropriate regulation and the rule of law can strengthen finan- cial markets and the domestic economy by attracting flows of foreign capital. Excessive regulation has the opposite effect when it imposes costs that cause capital and companies to flee a jurisdiction, writes Dr Richard Rahn. Richard W. Rahn is a member of the Board of Directors of the Cayman Island Monetary Authority and director general of the Center for Global Economic Growth, a project of the FreedomWorks Foundation.

Cayman has been successful because it has used a riskbased approach with regard to regulation. Over the years, we have seen many countries wound or destroy their financial industries by placing the heavy foot of government on the windpipes of those who create jobs and wealth. Unfortunately, my home country, the United States, has become the newest poster child for the consequences of excessive regulation. The former General Counsel of the U.S. Treasury, and now a fellow at the American Enterprise Institute (www.aei.org), Peter Wallison, has just published a very important study documenting the on-going destruction of the world's premier financial market. The Wallison/ AEI study is not only a belated warning to U.S. policy makers, but policy makers everywhere.

Wallison found ample evidence of the decline of the U.S. as the world's premier financial market. Specifically he found that:

Between 1996 and 2001, the New York Stock Exchange (NYSE) averaged fifty new non U.S. listings annually; in 2005, it gained nineteen.

London's AIM (Alternative Investment Market) had 335 initial offerings of securities in 2005 – twice the total in 2000, while Nasdaq had 126, down 65 percent.

In 2000, nine of every ten dollars raised by foreign companies were raised in the United States; in 2005, nine of the ten largest offerings were not registered in the United States, and of the largest twenty-five global offerings, only one took place in the U.S.

The government accounting office (GAO) found that the number of public companies going private increased from 143 in 2001 to 245 in 2004.

In 2000, nearly half, 46.8%, of the global IPO equity was raised on U.S. exchanges. However, in 2005, only 5.7% of dollars raised by non U.S. company IPOs was raised through shares listed on U.S. stock markets subject to U.S. regulatory rules and oversight.

The total inflation-adjusted value of securities class-action settlements increased to $9.6 billion in 2005 from $150 million in 1997.

The specific reasons for this documented decline in U.S. competitiveness are not hard to find. The Sarbanes-Oxley Act of 2002, which placed extremely costly additional financial burdens, is estimated to have "cost in lost market value of U.S. companies at $1.4 trillion." In addition, it appears that the requirement for independent-director majorities on corporate boards has reduced the willingness of corporations to take risks, which will have a long run, adverse effect on U.S. economic growth.

The Securities and Exchange Commission (SEC) has placed a number of costly, new regulations on companies that have not been justified by competent cost-benefit studies and engaged in a number of enforcement abuses, notably, charging companies in the press with a possible securities violation without sufficient proof, which makes them subject to SEC staff blackmail. The SEC also adopted a requirement that companies "expense" stock options, even though they are not an expense to the company. Venture capitalist and financial expert, Kip Hagopian, in a major article just published in the California Management Review, explained that stock options are a "shared benefit" and not an expense. Thirty financial, accounting and economic experts, including three Nobel Prize winning economists, have signed Hagopian's paper.

The poorly thought-out legislation and regulation, including attempts to "cure" problems that are not problems, have now clearly damaged the U.S. All jurisdictions are subject to pressures for unjustified and destructive regulation. These pressures come from: Regulators who desire to increase their staff sizes and power; Politicians who like to claim they are "solving" a problem while giving little thought to whether there really is a problem, and whether or not their "solu tion" will make matters better or worse; Regulatory compliance staffs within businesses who have a vested interest in more regulation; And the news media which, without giving any thought to the consequences, all too frequently like to demand more regulation to stop any "alleged" problem.

Cayman, like all jurisdictions, suffers from the above pressures to over-regulate, but it also suffers from attempts of large and less financially attractive jurisdictions and international institutions that they control to impose unjustified costs on Cayman. CIMA Legal Counsel, Langston Sibblies, has properly noted that there is an unfair imbalance between the number of financial regulatory regime reviews for offshore jurisdictions. On August 20, in a talk before the Eighth Annual Caribbean Commercial Workshop, he said, "The fact is that the Cayman Islands, like many other offshore jurisdictions, have undergone more reviews of our financial regulatory regime in the last eight or so years than most onshore jurisdictions." To date, Cayman has succeeded because of an enlightened business, legal and political class which understands the need for balance. Tim Ridley, Chairman of Cayman Island Monetary Authority (CIMA), was recently quoted as saying: "The private sector wants as little regulation as possible. But if there was some sort of crisis, that same private sector would ask what we had

been doing ourselves. There is no question that regulation is needed, but we must strike a balance to remain competitive.” The CIMA Board of Directors is very much aware that too little regulation can lead to major problems, and too much, like the U.S. has been experiencing, will kill the golden goose.