

## Reform 'Hysteria'

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*"Nothing so needs reforming as other people's habits."*

-- Mark Twain

Nothing now so needs reforming as "reform" itself. Every campaign for reform tends to exaggerate the evils it seeks to correct. Public opinion must not only be informed, it must be inflamed. Problems must seem so fearsome that no right-thinking person could doubt the urgency of action. The result all too often is the illusion of reform -- changes that confuse, disappoint and occasionally make things worse. The present stampede to purge corporate America of investor fraud is a case in point.

We are told that only tough reforms can stop accounting abuses and restore public "trust" in the faltering stock market. But no conceivable reform can by itself bolster the market, whose fall is mainly a reaction to previous speculative excesses. Intel's stock is now trading at about \$18, down from a peak of almost \$75, because its business has deteriorated and the stock got too high -- not because the company was dishonest.

As significant, Congress avoids less sensational changes that might reduce economic risk. Federal tax law encourages companies to take on debt, notes economist William Niskanen of the Cato Institute. Companies can deduct interest payments, but not dividends. In 1952 debt amounted to 40 percent of corporate net worth; now it is 75 percent. But Congress isn't considering changing the tax law. Nor is it facing the issue of stock options, whose explosion tempted executives to inflate profits.

Why be surprised? We live in an era of moral exhibitionism. Every reform moment is an opportunity for public figures -- politicians, TV commentators, columnists -- to strut their self-righteousness. These crusades become orgies of rhetorical self-promotion. This is why the present campaign to restore confidence in the stock market is, almost certainly, backfiring.

Starting with the president, politicians compete to show how outraged they are and how tough they'll be on corporate "crooks" and "cheats." Pundits ooze indignation. Is there any rhetorical exercise easier than assailing executive greed? Watching this spectacle, most sane investors must feel disillusioned. There are genuine scandals: WorldCom, Enron, Tyco. But the din of denunciation makes all of corporate America seem a cesspool of dishonesty.

It's guilt by public tantrum. If no one can be trusted, why stay in the market? The irony is huge. In the late 1990s, many of these authorities lavishly praised the "new economy" and thereby encouraged investors to buy wildly overpriced stocks. Now that many stocks have dropped to more reasonable levels, the implicit message is to sell.

Public relations drives "reform" politics. Debates emphasize ills to be corrected rather than distasteful choices to be made. Consider some other "reform" specimens. Advocates of "campaign finance reform" exaggerate the corruption of political contributions and deny that their favorite remedies impinge on free speech. But the recently enacted McCain-Feingold legislation restricts the ability of political groups to run "issue ads" within 60 days of an election. If that's not a limit on free speech, what is?

Or consider the Medicare "reform" to cover prescription drugs. This would be wonderful for people over 65. But it would be less wonderful for taxpayers. The costs are reckoned to be high and are probably underestimated. Is it true "reform" to increase the already huge money transfer from young to old? Congress ignores that question. Too inconvenient.

The present inconvenience is that the stock market's weakness -- which everyone wants to cure -- isn't fundamentally caused by accounting lapses, which are the focus of the "reforms." Perhaps the opposite. Recall some familiar figures: The historic price-earnings ratio of the Standard & Poor's 500 is about 14, meaning that a dollar of corporate earnings (profits) results in an average stock price of about \$14. At its peak, the recent market's P/E ratio rose to the mid-30s.

When stocks reach unsustainable levels, their inevitable fall will create resentment. People who sold at or near the top will inspire envy, and if these include top corporate executives (as they do), there will naturally be suspicions that they knew things others didn't. Companies will also be tempted to take accounting shortcuts to shore up stock prices. But the main problem of the bull market was reckless investing, not reckless accounting. People made bad decisions because they were gullible or greedy, not because they had bad information.

Although this is obvious, it is political poison to say so. After all, average investors vote. Even the press and pundits deemphasize the simple truths, because it seems ungracious to blame the market's victims for their own misfortune. Better to finger corporate greed and duplicity, which can be remedied by "reform."

Some proposals before Congress might improve accounting reliability. But financial markets are likely to cure accounting inadequacies faster than Congress. Having been hurt by misleading financial statements, big investors are demanding more detail and clarity. Companies whose numbers are suspect will suffer through lower stock prices. Some companies -- notably, Coca-Cola - - have even decided to include the cost of stock options in income statements.

By contrast, some congressional "reforms" clearly overreach. By a 97-0 vote, the Senate passed a provision to make "any scheme or artifice" that defrauded investors a crime. This sweeping language could unwisely criminalize any bad business judgment and invite random investigations by ambitious prosecutors. Its appeal is political. It allows senators to fulminate about how they're going to toss corporate thugs in the slammer. Great sound bites.

The trouble is that people listen to those sound bites, and when they reach a critical mass, they begin to alter the national mood. "Reform" is an exercise in advancing political reputations but not necessarily the public interest or popular confidence.