Don't go overboard

by The San Diego Union-Tribune

The Bush administration's plan to streamline and strengthen regulation of the ailing U.S. financial system had barely been leaked last week before critics denounced it as being woefully naive in its reliance on the self-policing, self-correcting powers of the free market. The collective irrationality seen from much of Wall Street during the housing bubble certainly doesn't inspire confidence in laissez-faire. Nevertheless, while we are not sure if the plan outlined by Treasury Secretary Henry Paulson goes far enough, it has two things going for it. The first is the lesson offered by the reaction to the last bubble, the Nasdaq-tech stock craze of the late 1990s. Outraged over evidence that many companies lied in their financial statements to prop up stock prices and dupe investors, Congress passed the sweeping Sarbanes-Oxley Act in 2002.

With every passing year, it is more obvious the legislation went much too far, with terrible results for the economy. Extensive internal audits required by the act have proven far costlier than forecast, wiping out profits for many small firms. The added requirements also drove many established foreign companies to stop listing their stocks on U.S. exchanges and prompted a stunning 90 percent drop in startup foreign firms making their initial public offerings here. This led Sen. Charles Schumer - a liberal New York Democrat who is no friend of corporations - to warn the United States' traditional leading role in global financial services was at risk.

That role could be lost forever if Congress adopts another far-reaching regulatory scheme that imposes unique-to-America costs - this time on banks, traders, exchanges, hedge funds and insurers.

The second positive aspect of Paulson's plan is that it is not nearly as toothless and reliant on more transparency and greater disclosure as has been depicted.

Unifying the regulation of stocks and bonds with the trading of commodity futures makes sense. So does unifying the regulation of banks with savings and loans. So does requiring state-chartered banks to meet national standards. So does establishing a mortgage commission to develop uniform federal lending rules. The net effect of all these changes would be to scrap an outmoded system that predated the emergence of financial players that didn't fit neatly into old categories and which struggled to deal with exotic new financial instruments, such as the packaging of mortgages as securities.

This is why the plan has drawn praise even from some proponents of broad government intervention. House Financial Services Committee Chairman Barney Frank, D-Mass., called it a "very constructive step forward," while also saying he was unconvinced the plan ultimately would prove strong enough in forcing reform. That is not far from our view. But for now, we think it pays to heed the lesson of Sarbanes-Oxley. Let's not risk crippling the economy in the name of saving it.

Nevertheless, it's a start. And, as Paulson himself notes, it will take several years to debate and fully implement these ideas. In other words, it will be up to a new administration, and a new Congress, to finish what Paulson began on Monday.

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