IDEAS ON LIBERTY
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Enron Shows Need for More Regulation?

It Just Ain't So!

In his December 24, 2001, *Business Week* column, journalist Robert Kuttner claimed the Enron scandal "suggests the need for tougher regulation." That Kuttner would make such a statement is not surprising; he consistently advocates increasing the government's power over our economic lives. But even many people who are generally sympathetic to economic freedom are questioning their belief that an unregulated market works best. But the Enron debacle happened in a regulated market. Without such regulation, the Enron crisis would likely not have been as severe as it was.

Consider financial regulation. Kuttner writes, "Only regulators (and their proxies, such as the Financial Accounting Standards Board) can force corporations to disgorge potentially embarrassing information." When I read such a statement, I don't know whether to laugh or cry. Kuttner correctly identifies the FASB as a proxy regulator: the Securities and Exchange Commission, a government agency, requires corporations to comply with standards set by the FASB. Which means that Kuttner, who advocates increased regulation, is arguing that only the kind of regulation we have will work. There's one little problem with his view: the current regulations didn't work. The agencies that Kuttner trusts as the only ones that can force embarrassing information into the open didn't do so.

But wouldn't we have even more Enrons if we got rid of all regulation? Probably not. The reason is that many of us value information about the firms we invest in and we are willing to pay for that information. Why do I trust the toaster I buy not to explode in my face and the motel I stay in to have clean sheets? There are two main reasons. First, the companies making these products treat customers well in order to establish a reputation for quality. A famous example of a firm that did well by producing a safe product, while those about them were producing dangerous ones, is Standard Oil of New Jersey. Kerosene, which began to be widely used in the late nineteenth century, had a nasty habit of blowing up and burning people to death. The reason: the product was not standardized. John D. Rockefeller came along and standardized it so that people knew it was safe: thus the company's name, Standard Oil.

The other reason we trust products and services is that private certifying organizations such as Underwriters Laboratory (UL) diligently examine firms' products to make sure they meet their standards. If tomorrow the government stripped the FASB of its government-granted monopoly on standards, then certifying agencies would come along that would give publicly held companies the equivalent of a UL certification.

But wouldn't companies aggressively game the system, as Enron did, to find ways to meet the standards while still misleading the public? Possibly, but a private certifying agency, with its own reputation at risk, would have a stronger incentive to spot these shenanigans quickly than does a government-backed monopoly with zero wealth at stake.

Kuttner goes for the hat trick, using the Enron scandal to argue for increasing regulation in two other areas as well. First, he claims, Enron's large profits in California's electricity market show that deregulation of electricity doesn't work. It shows no such thing. California's government did not deregulate electricity in the mid-1990s; it re-regulated it, replacing the old rate regulation with some new regulations that only a market socialist could love. One of the new reg-

ulations was a vertical disintegration of the industry, which forced retail electricity providers to buy their power from generating companies. A related regulation prevented the retailers from having any contact with those who sold them the electricity, and also prevented them from buying on anything other than the daily spot market. In other words, all trades had to be made anonymously. One final regulation required each buyer to pay the highest price agreed to by any buyer that day. What that meant was that in times of short supply, generating companies would be foolish not to charge high prices. Refraining from doing so would not establish a reputation that would help them because no electricity buyer would be able to knowingly give his business to such a company in the future. This regulatory brew certainly did help Enron, but if this was deregulation, then Sweden's economy is laissez faire.

Coerced Employee Stock Ownership

Kuttner also claims that "Enron employees were coerced to put the bulk of their tax-subsidized retirement savings into—guess what?—Enron stock." He's right about coercion, but wrong about the entity doing the coercing. Enron gave its employees strong incentives to hold Enron stock in their 401(k) plans. But Enron never used coercion. Rather, it gave them what looked like a sweet deal due, in part, to the federal government's coercion of Enron. Specifically, the Employee Stock Ownership Plan, introduced by the federal government in 1974 with the Employee Retirement Income Security Act, gave companies a tax cut for selling stock to its employees. In other words, the federal government coerced money, literally, out of companies if they didn't play along and then reduced the coercion if they had their employees own stock.

Kuttner writes that it "should be illegal" for a corporation "to force its employees to put all their retirement eggs in one basket." I agree. But the issue is irrelevant because as mentioned above, Enron didn't use force. Even if Enron insisted that its employees buy its stock, which it didn't, that simply would have been terms of a contract that every Enron employee was free to refuse by not working there. But Kuttner probably knows that, and is misusing the language of coercion to hide his own advocacy of real coercion. If a company and its employees agree, unwisely in my opinion, that they will hold only the company's stocks in their 401(k)s, I'm guessing that Kuttner would want to stop them—using real coercion, the kind that puts people in jail for resisting.

After detailing all the ways in which Enron and other companies should be regulated, Kuttner writes: "Enron was the ultimate politically engaged company. Its chairman, Kenneth L. Lay, was an intimate of the Bush family and was wired to Democrats as well. Enron's operatives relentlessly lobbied state legislatures to provide a lax climate in which to pursue its market manipulation.

Kuttner is half right. Enron was "the ultimate politically engaged company." But, as Cato Institute's Jerry Taylor pointed out in the *Wall Street Journal* (January 21, 2002), the only thing consistent about Enron's lobbying was that it was in Enron's self-interest. If this meant lobbying for deregulation, then fine. If it meant lobbying, as in California, to get utilities out of generating electricity to make room for Enron, and for strict price controls on the use of transmission grids, then that was fine too.

Does Kuttner really think that increasing regulation will make companies lobby less?

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This Is America?

by James R. Otteson

I have long had an uneasy relationship with airport security. Before September 11, I resisted the demand that I produce a *government*-issued ID, believing that it smacked too much of the "Papers, please" of the former Soviet Union that Hollywood movies used to mock and we free Americans used to laugh at.

I also used to withhold permission to search my bags. On one occasion before September 11, in the Birmingham, Alabama, airport, the security guard was nonplussed when I answered no to her perfunctory request for permission to search my briefcase. I told her, and then her supervisor, and eventually a man who identified himself as the head of security at the airport, that I am protected by the Constitution from unreasonable searches and seizures. I showed him the Fourth Amendment in the copy of the Constitution I always take with me when I travel. It meant, I said, that unless they had either a warrant or probable cause to suspect me of some crime, they had no right to demand to search my bag. They admitted that they had neither, but, in what was then a shocking revelation and now seems only to have been ahead of its time, the chief of security said: "Well, you have *your* law; I have *mine*."

That was before September 11. Since then, all sanity—not to mention quaint notions like individual liberty, rights, and privacy—is fast going the way of the Edsel.

Several weeks ago in the airport in Traverse City, Michigan, my wife, my children of 8, 5, and 3, and I were all "randomly" selected for a complete search of all our belongings. I have never been subject to more humiliating treatment in my life. We all—including my three-year-old son—had to take off our shoes, and hand them over for "inspection." I had to take off my sport coat and belt as well; and I had to hand over my wallet for it to be—well, who knows?

I made my usual protest about protections from unreasonable searches and seizures, but they fell on deaf ears. "We're just following orders," I was told. That was the defense Nazi war criminals used, I said. Following orders does not relieve you of responsibility for your own actions. "Are you calling me a Nazi?" one demanded. "You call me a Nazi again and you're *never* getting on that plane!"

Whose orders are you following? "The FAA's." The FAA has instructed you to detain and search innocent American citizens and their families? "Where have you been lately, buddy? Haven't you heard of what happened in New York?" But wasn't that tragedy, like most terrorist activities against America, perpetrated by people who were *not* native-born American citizens, and who were *not* traveling with their wives and small children?

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