

It Boils Down to TRUST

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June 26, 2002: First it was Enron and Global Crossing. Now it's WorldCom and Martha Stewart. Stocks gyrate wildly. Chicken Little resurfaces: Is the sky really falling?

Headlines on AOL June 27, 2002: "FatCats: What They Cost You", "Special Report: Crisis in Corporate America", "How Corrupt is Wall Street?", "How Bad Can It Get?", "How Have You Been hurt?"

Is it really that bad?

The simple answer is "no." Corporate and financial misbehavior is nothing new any more than scandals in Congress over campaign contributions or sexual escapades. They are always with us. We've been here before and we have made it through and prospered in spite of it.

Somewhat clouded by the negative emphasis in the media are the many positive reports that should receive at least as much focus. I am going to deal with the negative, but first I want to list some positives:

1. [Most business people are basically honest, hardworking people](#) trying to make profits for their shareholders, their employees and themselves. Our standard of living is the greatest the world has ever known and it is the fruit of these people's labors. Go home and inventory the conveniences you live with each day. Cars, microwaves, computers, air conditioners, hot tubs, plumbing, electricity, cell phones, DVDs, medications, clothes, food, houses, hoses, plastic bags, trash pick-up... and the list goes on and on. Stand up and cheer for the companies that provide all this! GOOOOOOOOAAAAAAAAAALL!!! Come on, it is so easy to criticize and look at the negative. The "evil doers" are the minority. The good doers are the majority. Let's not let the media or politicians convince us otherwise. And let us be determined that the good doers win!
2. [The fundamentals of the economy are healthy.](#) House sales, employment, productivity, interest rates, inflation and a host of other indicators are either positive or showing improvement.
3. [The evildoers are being exposed.](#) This is good. Let's root them out so the rest of us can get on with being productive.
4. [The sun is shining, children are playing, birds are singing, lovers are loving and the waves still break beautifully on the seashore.](#)

Tackling the Problems

Prudence dictates a certain realism and acknowledgement that there are problems. The recent spate of corporate scandals, especially as they relate to dishonest or disingenuous accounting practices is a serious matter.

The crimes described in the headlines are not minor. They should not be glossed over or considered to be inconsequential "white collar" offenses. These are not matters that only affect an individual or a family or small group. They do not equate to inflating a deduction on your taxes or having an affair or taking an illicit drug or speeding on the Interstate. These are heinous crimes because they attack and damage the heart of the economy. That heart is trust. Without trust in the basic institutions, an economy cannot function. When someone behaves in a way as to undermine the trust people have in companies, that person commits a serious crime, as serious in many ways as terrorists blowing up buildings.

And I should also mention that there is behavior that may not be criminal but it nonetheless is reprehensible. Each year the Pittsburgh post-gazette lists the 50 highest-compensated executives in the Pittsburgh area. On more than one occasion I have felt anger at the millions of dollars paid to someone who in my estimate has done a lousy job, who has overseen the deterioration of a company, who has laid off hundreds or thousands of workers yet who has become rich and has provided himself (or herself) with "golden parachutes" and perks that provide an easy mark for those who would like to see the free enterprise system be a lot less free.

Company leaders, auditors and private investors who lie, cheat, steal or otherwise destroy portions of our economy do damage to us all. They contribute to and are very responsible for the extent of this bear market. They should be punished or disciplined. Politicians, judges, accountants, stockbrokers, lawyers and bureaucrats who mismanage their own fiefdoms should be held equally accountable.

The economy is our most precious practical institution. Everything we do, whether we travel, feed our family, do charitable work or go to a movie, requires economic exchange. This is why any act that damages the economy and our trust in it is so serious.

Therefore, we should not only expose those who have done this damage, we should make them pay for it as much as possible. Let's find out who is responsible for the ENRON, Worldcom, Xerox and other severe business deceptions, throw the lot in jail and fine them heavily enough so they at least have to live like the majority of us when they get out. And if it is proven that Martha Stewart used unfair insider knowledge to cheat on her investments, she also should receive a significant penalty that will make others think twice before cheating.

The Answer Isn't More Regulation

Pennsylvania Senator Rick Santorum in a radio interview said that a new government agency was needed to oversee the accounting industry. I felt like screaming. This is the typical knee-jerk politician's response. Oops, someone broke the law. Hmmmmnn... let's make more laws making it illegal to break the existing laws. The only people this helps are attorneys and bureaucrats.

The existing regulatory environment is part of the problem. When there are too many rules and regulations, it is actually easier for the "evil doers" to hide behind the very complexity ostensibly designed to control them. And the more government agencies there are the worse it is. It is amazing to me how politicians can take understandable concepts and very simple and straightforward documents such as the Constitution and virtually negate them by layering on all sorts of unnecessary rules and regulations.

Regulatory oversight in the economy should simply reference two primary rules: Thou shalt not steal and thou shalt not bear false witness. A secondary rule that reflects off the other two would be "thou shalt not cheat." (Cheating is an act that may not be technically stealing or lying, but it produces similar damage in the marketplace.) With these three simple rules an economy can be fairly governed.

Find ANYONE violating these and punish them swiftly and commensurate with the magnitude of the offense. Leave the "good doers" alone.

But that's not how it works. I can tell you from my own experience that the regulatory bodies too often emphasize form over substance. They punish the majority of the good doers for the acts of the minority of evildoers. They are overwhelmed and incapacitated by their own rules. They couldn't find Enron in a haystack... until after the damage had already occurred. We are over regulated, not under regulated.

Mr. Santorum, PLEASE! We don't need yet another ineffective government agency just so you can tell your constituents you are doing "something" about the problem. It will be a waste of time and our tax dollars. Ultimately it will cost the economy more than it saves. The laws already exist to take care of this. They just aren't being used. Please, Senator, don't compound institutionalized stupidity with more institutionalized stupidity.

The government has been mostly ineffective in preventing the abuses of companies such as Enron, WorldCom, and Xerox and the use of "insider" information for unfair gain. This is not the first or last time such offenses have occurred. Ultimately the marketplace disciplines itself better than the government, and that is what is happening now. As I said in an earlier letter, "The stock market exists to discipline greed and reward discipline."

Another government agency will simply be burdensome and ineffective. If anything, we should do away with the existing agencies and have only one covering all business, which might be called the Commission for Honest, Orderly and Fair Economic Practices (CHOFEP) or the Economic Integrity Commission (EIC). The government should simply provide a few clear and easily understood rules, reporting formats and the basic consequences (i.e. jails and fines) and then let the marketplace function with as little interference as possible.

Answers (or at least a start to getting them)

Please note that I am not anti-regulation. I am for simplified and practical regulation that enables the marketplace to function optimally. To minimize future abuse and restore trust, three focus points should receive attention.

1. Simplification

The regulatory environment needs to be simplified. Standards should be clear and understandable and should not create a compliance burden. In addition, the tax codes should be simplified to reduce the amount of game playing to avoid taxes. I would go so far as to eliminate most taxes and replace them with a national sales tax.

2. Disclosure

Certain disclosures should be required of all businesses, organizations and governments. The formats should be simple, understandable and verifiable. The most important items of disclosure:

- a. Sources and Amounts of Income
- b. Expenses
- c. Assets, Liabilities and Net Worth
- d. Conflicts of Interest
- e. Compensation and Relationships of Officers, Directors and top Executives
- f. Product and Services Descriptions and Information

3. Education

Educate the public about what Lying, Cheating and Stealing look like and give them 800 numbers to call if they suspect anything. This allows the marketplace (which includes the consumer) to better discipline itself, using the government agency as a resource. This is much better than the government agency “lording” it over the businesses with burdensome paperwork and picayune filings.

4. Enforcement

Focus on the violators. Make punishments severe enough to truly discourage lying, cheating and stealing.

5. Relief for the Good People

If a company is not causing problems, leave it alone. Reduce the compliance burden. Concentrate on the evildoers, and make it easier for the rest of us to do business.

I am realist enough to know that while all this may sound good, the devil will be in the details. But that should not stop us from seeking an optimum balance between regulation and a free marketplace. Right now our regulations are too cumbersome and ineffective. So rather than add to these, we should attempt to minimize and simplify them towards greater effectiveness that will also allow greater productivity in a free marketplace.

In this manner we can restore the trust that has been damaged. We need to be able to believe in our businesses and the government.

It all boils down to trust. Erode it further and we will face harder times. Build it up and we will have a much better future.

