Wall Street has no need to join a race to the bottom

By Jeffrey Garten
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Since last summer, Hank Paulson, US Treasury secretary, and a bevy of executives from Wall Street and corporate America have been sounding an alarm over what they see as the eroding competitiveness of US capital markets. They have been pushing for a relaxation of certain Sarbanes-Oxley provisions; changes in the US accounting culture that would favour the use of broad principles over detailed prescriptions; constraints on lawsuits for corporate malfeasance; and consolidation of the fragmented regulatory structure. The latest salvo came last Thursday whena blue-ribbon private sector group issued a 135-page report on problems and remedies.

Mr Paulson's experience in financial markets and his efforts to revitalise President George W. Bush's economic team are just what the US needs. Efforts to balance better the costs and benefits of regulation are always to be applauded. Nevertheless, there are serious flaws in the underpinnings and timing of this omnibus initiative.

Start with the weak reed on which much of this hand-wringing rests - that the New York Stock Exchange and Nasdaq are losing international initial public offerings to foreign stock exchanges because of too much US regulation and litigation. From any standpoint, America dominates public capital markets, with the US exchanges accounting for more than half of the world's stock market capitalisation. Furthermore, even if the US were to win more listings, the questionable quality of many of the Russian companies that are financing themselves in London and the Chinese companies that are going public in Hong Kong - including lack of disclosure, opaque ownership structures, poor protection for minority investors and behind-the-scenes government manipulation - would force the US Securities and Exchange Commission to weaken its protection of American investors.Who would advocate that race to the bottom?

Capital markets comprise much more than IPOs. Private equity, hedge fund and venture capital investments - activities that create thousands of billions of dollars of value, risk hedging, and innovative businesses - are critical, too. Here, US firms such as The Blackstone Group and Kleiner Perkins dominate the scene. In addition, the rise of London and Hong Kong as financial centres is a natural rebalancing of power and influence to match the dispersion of global growth. AsMr Paulson himself has said, such growth benefits the US economy; it is not a sign of its weakness.

If competitiveness were flagging, we would see diminished dynamism of US markets. However, the Chicago Mercantile Exchange is merging with the Chicago Board of Trade to form an exchange twice the size of the NYSE. The separate self-regulatory bodies of the NYSE and Nasdaq are joining forces. Last month was the best in six years for US IPOs and mergers. The US financial scene is hardly a picture of complacency.

Perhaps concerns should be based on fears about jobs that pay well. Unlike the stagnant wages of America's middle class, however, the average weekly remuneration of financial services employees in New York increased this past quarter from a year ago by nearly 30 per cent. In addition, executive bonuses may be at an all-time high. Maybe Wall Street firms themselves are hurting? Lehman Brothers profits have more than tripled since 2002. Bear Sterns is having the best results in its history.

A second big flaw in the new drive to overhaul the financial markets is the anachronistic concept of national competitiveness as applied to capital markets, especially in an era when all funds move across borders electronically. The US economy is a significant beneficiary of this international marketplace whenever it turns to China or Saudi Arabia for loans to finance its domestic investment. American firms such as Goldman Sachs and JPMorgan are winners, too, because they are important underwriters, whether it is the Industrial Commerce Bank of China issuing shares in Hong Kongor Rosneft, the Russian oil giant, offering its stock in London. American citizens can easily purchase securities of foreign companies through Fidelity Investments or Merrill Lynch or dozens of other such firms; indeed, retail investors have been pouring three times as much money into foreignequities compared with domestic shares.

Given the momentum behind financial reform, the regulatory pendulum could swing too far in relaxing the safeguards and procedures for a capital market that has served America spectacularly well. At a time when the economic lifeline of more and more Americans rests on their private investments and not on government programmes, this is a dangerous moment for Washington to abandon the public interest for special interests.

With limited time and resources, the administration would do better to address more acute weaknesses in America's competitive arsenal. That would include better workforce training, a reduction in the burden of healthcare costs on industry and reversal of the decline of basic research. Can anyone, though, slow this misplaced juggernaut for broad-scale overhaul of our capital markets?

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