THE WALL STREET JOURNAL.
CLASSROOM EDITION

DEBATE: REGULATING FINANCIAL MARKETS

1. Focus Have students find the meaning of each of these words before they begin to read: *creditors, disclosure, fraud, incentives, manipulation, populist,* and *subsequent.*

Explain to students that they will be conducting a debate on whether the U.S. government should impose tariffs on imported goods. Inform them that they will be responsible for arguing one side of the issue. Remind students that a well-prepared debater supports a position with valid evidence, logical arguments, and responsible appeals to emotion.

2. Instruct The authors have both researched the impact of import tariffs on domestic goods. Have students conduct further research on taxing international trade from credible sources before conducting the debate.

Remind students that they should use the following debate format:
The affirmative side will:
- State the problem to be solved. Why is this problem significant?
- Explain who or what is harmed if the problem is not resolved. Use factual evidence to quantify the harm.
- Propose a plan of action. Explain why it is better than the current system.
- Provide factual evidence to show how this plan will solve the problem.

The opposing side will:
- Refute the arguments of the affirmative side, using factual evidence to quantify and support its position.
- If necessary, support the status quo's ability to solve the problem.

3. Close/Reteach When the debate is concluded, encourage students to discuss their opinions on the issue. Ask them whether they were persuaded by the other side's arguments. Conclude by having students write their own statements supporting or opposing tariffs placed on international goods.

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DEBATING CURRENT ISSUES: *Regulating Financial Markets*

In the early 2000s, investor confidence in the stock market was shaken by a series of scandals. To restore the faith of investors, Congress passed legislation to regulate corporate accounting.

In this debate from *The Wall Street Journal Classroom Edition,* Randall Dodd, director of the Financial Policy Forum, and U.S. Congressman Jeff Flake, an Arizona Republican, argue whether the market would function better with more regulation—or less.

YES *Should the government increase its regulation of financial markets?*

BY RANDALL DODD

Financial markets work best when investors are fully informed and the markets are free of fraud and manipulation.

In an unregulated market, investors will not have enough information to guide their investments, which should not be based on rumor. Companies have incentives not to share information, such as bad news about themselves or information about others that is not commonly known. That's why regulators require companies to fully disclose information. That way, the entire market is better informed. This results in a greater willingness of firms or individuals to invest.

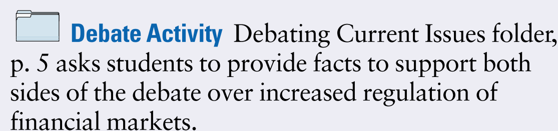
U.S. financial markets did not become world-class until after regulations made them honest and more stable. Today they are suffering from a lack of trust.

Fraud and the manipulation of market prices rob investors of a fair return on their money and this discourages investment and harms the entire economy. But possible gains from cheating apparently have become more of an incentive to many than the loss of a good reputation, so the destructive activities continue.

Another reason regulations are important is because risks taken by one financial firm can harm not only that firm but other companies as well. When a business fails it harms not only its employees, clients, vendors, and creditors but also the firms that lend money to the creditors, clients, and vendors. Yet this potential loss to others does not restrain firms from taking greater risks.

In order to limit harm to others, better regulations are needed. We need new investment rules for the managers of pension funds and insurance companies. The government must regulate financial markets to protect investors, corporations, and the financial system as a whole.

Corporate accounting scandals rattled American financial markets in the early 2000s. Would new regulations prevent future scandals?


Debate Activity Debating Current Issues folder, p. 5 asks students to provide facts to support both sides of the debate over increased regulation of financial markets.

Economic Assessment Rubric
Economics Assessment Rubrics folder, pp. 14–15 provides sample evaluation materials for participation in debates.

Background

About the Authors

Presenting an argument in favor of increased regulation of financial markets is Randall Dodd, director of the Financial Policy Forum, who argues that more intervention is required in the financial markets to protect investors' interests. U.S. Rep. Jeff Flake, an Arizona Republican, argues that markets work best with less regulation.

NO Should the government increase its regulation of financial markets?

By Rep. Jeff Flake

It did not take long after the wave of corporate wrongdoing for the populist calls for more government regulation of our financial markets to start.

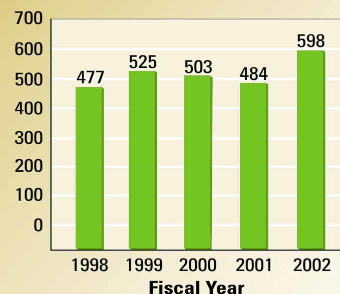
Some argue that a lack of regulation allowed unscrupulous companies to deceive investors. An unregulated market exists only in theory, but in such an environment, companies could keep important information to themselves and away from investors. Investment has to begin at some point, however, and the first potential investors—if they have any degree of concern for their investment—would only agree to take ownership in the company in exchange for influence over management.

If the initial and subsequent investors do not receive acceptable returns, they will demand more information from the company, a change in management, or they may withdraw their investments. This is the incentive for companies to provide accurate and complete disclosure.

Regulators say that we need to protect investors and the broader marketplace from debacles like the Enron mess. But the economic system that allows for possible risks like Enron has also allowed for the solid lasting profitability and success of thousands of other companies. Restraining the system with more regulation may catch some failures, but it will also hold back many success stories.

Finally, many make the case for more government regulation by arguing that government needs to do more to prevent fraud and manipulation. However, as soon as new regulations are in place, new loopholes will inevitably be created. Frauds and manipulators, who have shown little regard for existing regulations, would not likely respect new regulations.

The long-term impact of increasingly strict rules and regulations can be just as damaging as the fraud and manipulation that occurs in an open system—probably more so. The increase of rules and regulation adds costs and administrative effort. In effect, companies face disincentives to engage in fair and honest exchange. Thus, overregulation is also a destructive activity.



The Securities and Exchange Commission (SEC) begins an "enforcement action" if a public company is believed to have broken SEC rules.

DEBATING THE ISSUE

1. According to Randall Dodd, how do fraud and manipulation of market prices hurt the economy?
2. Why does Rep. Flake believe that a new set of financial regulations prohibiting corporate abuses won't solve current problems?
3. **Testing Conclusions** What evidence is there to support Rep. Flake's belief that new regulations will have unintended consequences?
4. **Reading Graphs** In which year between 1998 and 2002 did the SEC launch the most enforcement actions against companies?

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Differentiated Instruction L3

Sarbanes-Oxley, which addressed Wall Street, corporate, and accounting-industry reform, was set up to improve the quality of corporate financial information, and to make it less likely companies are manipulating their earnings numbers. Ask students to assume the role of stock-market investor. Have them discuss and prepare a report on the benefits and risks of investing in the stock market today. How much confidence would students place in buying shares of companies that are operating under this new legislation? Do they think that investors are receiving accurate earnings information? How risky is it to invest in the stock market today? Why?

Go Online PHSchool.com Students can find additional links related to the debate by visiting the *Economics: Principles in Action* site at PHSchool.com.

Interdisciplinary Connections: History

Corporate Scandals The corporate scandals of the early 2000s shook investor confidence in the stock market and resulted in many workers losing their pension or retirement funds. But this was not the first time that investors had become victims of fraudulent-accounting practices and other corporate wrongdoing. Other episodes occurred during the populist and progressive eras at the turn of the last century and at the start of the Great Depression of the 1930s.

Making the Connection In groups, have students research one of the following time periods: 1920, 1930, or 2002. Have groups present an illustrated essay or PowerPoint presentation on this topic: "Periods of United States History Marked by Government Intervention in Private Enterprise." For each time period, groups should discuss the president in office, the business problem, the group(s) affected, and the government action taken.

Answers to . . .

1. They rob investors of a fair return on their money, which discourages investment and harms the entire economy.
2. In the corporate scandals of 2002, it mattered little that laws were already on the books prohibiting many of the actions that led to these scandals.
3. Rep. Flake offers his opinions on regulations. He uses the "corporate inversion" example to illustrate the consequences of unfair federal tax policy.
4. FY02