

Rising Recovery Threatened by Regulatory Zeal

Contributed by Kerri Houston
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Finally, the U.S. economy is showing signs of solid growth. So why has Securities and Exchange Commissioner William H. Donaldson decided to poke it in the eye with a sharp stick?

Regulators often regulate just because they can, and the SEC has decided to do just that as it lurches toward recommending mandatory expensing of stock options. Corporations can currently choose between expensing stock options when they are granted or diluting them when they are exercised. Industry analysts estimate that if mandatory expensing of stock options had been in place in 2002, net earnings for the S&P 500 would have dropped 23%. Yet regulations currently being considered by the Financial Accounting Standards Board (FASB) would remove the choice from corporations and require business to treat stock options as an immediate expense.

There are several problems with this regulatory scheme. First, it removes from corporate administration both the ability to make its own decisions on how to attract employees as well as control over internal stock management. Secondly, several studies have shown that stock options, as the partnership or "equity culture" model of corporate ownership, increase productivity and overall shareholder return. Economists believe that mandating expensing will eventually eliminate options, and thereby the boost to the economy, the company, and the individual workers that options provide.

Lastly, how does one calculate the "value" of a stock option given today that won't be exercised until some future date? How do you know when the employee will exercise it, what the stock price will be at that date, and what volume of share will be cash in? Crystal ball?

Fans of mandated expensing have actually come up with a plan - the "Black Sholes model" - a formula that allows them to pull a number right out of mid-air to justify their position. Ironically, even Mr. Sholes is on record in Barron's explaining that his model is not good enough for this purpose.

The President has come out firmly against the idea, as has NASDAQ, and hundreds of companies nationwide. Recently a coalition letter was sent to Chairman Donaldson expressing opposition to mandated expensing by a number of free-market, limited government organizations including Frontiers of Freedom, Institute for Policy Innovation, National Taxpayers Union, United Seniors Association, Americans for Tax Reform, and the Small Business Survival Committee.

However, in a misguided post-Enron public relations effort to throw the baby out with the bathwater, as FASB considers this damaging new reg, the SEC Chairman has made public statements in favor of mandatory expensing.

In July, Chairman Donaldson was asked publicly whether he agrees with his boss, President Bush, that stock options should not be a mandatory expense. His response: "It's clear to me that there is an expense associated with stock options ...we've got to reflect that value in the profit-and-loss statement."

This pro-expensing stance shows indifference to the view expressed by President Bush, who stands firmly against excessive government regulation of business practices. It also overlooks the example set by so many companies whose

growth was derived from the flexibility to decide whether to account for their stock options now or later. Pro-expensers clearly skipped "Origins of the Tech Boom" class.

Microsoft, whose internal wealth as well as its contribution to the American economy was driven by its stock plan, might be the best example of why stock options work. In 2001, Microsoft employees in the Washington State made \$2.4 billion in wages and \$3.5 billion in stock-option income.

What's right for a company at one time may not suit it at another: When Microsoft recently decided to stop offering options, it was exercising the power it currently has to decide whether or not to offer options to its employees. This choice gives companies the freedom to operate under whatever structure best suits their contemporaneous business needs. This is the bottom line of the debate - let companies decide.

In the current climate of limited venture capital, stock options give companies a tool to recruit, retain and reward the best employees available. Employees' sense of ownership, of having a stake in the company's future success, boosts morale and fosters healthy competition. It would be foolhardy to take that away now, amid increasing pressure for economic recovery.

The greatest economic challenge we currently face as a nation is getting people back to work in a steady but slow post 9-11 recovery. Stock options are a tool in putting people back to work. Why would anyone want to mess that up?

As Grandpa used to say "if it ain't broke, don't fix it." We can only hope that FASB and Chairman Donaldson can resist scratching their itch to regulate, and eventually decide against recommending a rule that undermines the healing of our economy.

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