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A Problem in Complexity: Congressional Legislative Failures

Judging the efficacy of legislation requires one to examine not only a law's direct effects but also to analyze a law's incidental effects. Often laws achieve their stated goals but produce such detrimental side effects that they are clear failures. Rent control laws may be an example.[1] While generally speaking such laws lower or stabilize rental prices for some, the incentive effects of artificially low prices create a shortage of low-income housing and a decline in building upkeep and habitability.[2] Cities with relatively strict rent control laws often have relatively high levels of homelessness.[3] Unfortunately, rent control laws are just one example. Although it is not obvious why legislation often fails, the answer may boil down to a simple observation: we live in a complex world. Ultimately, this paper proposes two possible reasons for the common failure of congressional legislation. First, society's interconnectedness limits anyone's ability to predict the results of proposed legislation thus making effective legislation highly unlikely. Second, Congress's systematic make-up as a political institution suggests that ineffective legislation essentially is an emergent behavior that cannot be corrected without institutional changes to policymaking. Furthermore, to draft effective legislation, Congress may need to limit any potential regulatory scheme to a closed system. This paper will proceed in three parts. First, it will succinctly discuss Complexity Economics[4]: the theory underlying the above propositions. Second, it will discuss Complexity Economics' relationship to

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[1] THOMAS SOWELL, BASIC ECONOMICS 40-48 (3rd ed. 2007).
[2] *Id.* at 44.
[3] *Id.* at 45.
[4] ERIC D. BEINHOCKER, THE ORIGIN OF WEALTH: THE RADICAL REMAKING OF ECONOMICS AND WHAT IT MEANS FOR BUSINESS AND SOCIETY 19 (2007).

congressional legislation. It will conclude by analyzing the effects of certain legislative responses to the Vietnam War, September 11th, and Enron's collapse.

I. Complexity Economics

Complexity Economics is a function of a radical idea: the economy is a complex, evolutionary system.[5] It is radical because it contradicts much of the standard economic theory developed over the last century.[6] This contradiction is a product of the recognition that traditional economic theories—whether Keynesian, Classical, or Monetarist—make several unwarranted assumptions that limit their usefulness in analyzing and predicting real world economic behavior. These include perfect rationality[7], an unrealistic view of time[8], and a reliance on diminishing marginal returns.[9] The resulting economic models portray a world where economic actors utilize all necessary information only to pursue their economic self-interest in extremely "complex and calculating ways."[10] Ultimately, this behavior produces a closed equilibrium system[11] governed by the law of supply and demand.[12] In these models, economic movement such as growth, recessions, and stock market volatility are explained as the result of exogenous shocks to the closed system.[13] Essentially, the economy jumps from temporary equilibrium to temporary equilibrium.[14] Unfortunately, traditional economic theory produces a world that barely resembles the one in which people actually live and often fails to predict or explain actual economic events and phenomenon.[15]

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[5] *Id.* at 16.
[6] *Id.* at 47.
[7] *Id.* at 47.
[8] *Id. at 52.*
[9] *Id.* at 56
[10] *Id.* at 51.
[11] *Id.* at 70.
[12] *Id.* at 60.
[13] *Id.* at 54-55.
[14] *Id.*
[15] *Id.* at 21. For example, few economists predicted the financial crisis of 2008-09.

Out of frustration with traditional theory, some scientists and economists currently are developing a theory of economic behavior known as Complexity Economics.[16] Although still in its intellectual infancy, this theory attempts to model the economy more closely to actual economic behavior thus enabling economists to be better predict economic activity. The basic proposition of this new theory is that an economy is an open dynamic or a complex adaptive system akin to a "body's immune system, . . . an ecosystem, or users on the [I]nternet."[17] As such, instead of being a closed equilibrium system subject only to exogenous shocks, the economy is a vibrant changing system prone to booms and busts not based on exogenous phenomenon but rather due to the endogenous, evolutionary interactions of economic actors.[18] Thus, the economy never reaches a single, stable equilibrium but rather is constantly in motion.

For the purposes of this paper, the complex adaptive economy displays three important characteristics: dynamics, networks, and emergence.[19] Dynamics refers to the fact that the economy is constantly changing.[20] This obviously is not a surprise as the economy regularly experiences growth, recessions, and inflation. Complexity Economics attributes this dynamism in large part to positive and negative feedbacks.[21] Positive feedbacks are reinforcing connections within the economy that magnify the effects of relatively small changes.[22] Examples are increasing returns in the technology industry and the observation that natural disasters lead to heightened unemployment and potentially to recessions. Positive feedback connections enable systems to exponentially grow, collapse, or completely change.[23] Negative feedbacks are a

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[16] *Id.* at 19.
[17] *Id.* at 18.
[18] *Id.* at 19.
[19] *Id.* at 97. Two other important characteristics of a complex adaptive economy are agents and evolution. *Id.*
[20] *Id.* at 100.
[21] *Id.* at 101.
[22] W. Brian Arthur, *Positive Feedbacks in the Economy*, 262 SCIENTIFIC AM. 92, 92 (1990).
[23] BEINHOCKER, *supra* note 4, at 101.

diminishing connection that inhibit change and tend to produce a static, equilibrium state.[24] Examples include the law of supply and demand or a progressive tax system whereby as a company grows that company gets to benefit less from that growth. Furthermore, Eric Beinhocker describes the economy's dynamic state as a byproduct of idiosyncratic stocks and flows of economic actors.[25] A stock simply is a base state such as a worker's set of skills or a corporation's current capital. A flow refers to change such as the above worker's continuing education or the above corporation's recent stock offering. Thus, although change is the norm in the economy, it is path dependent or a product of a previous state.[26]

Networks refer to the almost infinite number of connections within the economy. These connections include water systems, roads, television, the Internet, cellular telephones, and markets—to name a few.[27] These connections allow people, either individually or through organizations, to leverage information and therefore greatly increase innovation and consequently wealth.[28] However and significantly important to policy analysis, greater connectedness increases the likelihood that that a change in one area will have large and unforeseen consequences in another area through unknown positive and negative feedbacks.[29] Thus, when taking into account the billions of stocks and flows in the economy and the interconnectedness of the economy displayed through positive and negative feedback connections operating through networks, it is not surprising that economists do a poor job predicting economic outcomes.[30]

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[24] Arthur, *supra* note 22, at 92.
[25] BEINHOCKER, *supra* note 4, at 108.
[26] *Id.* at 106.
[27] *Id.* at 141.
[28] *Id.* at 150.
[29] *Id.* at 151.
[30] *Id.* at 109.

Finally, instead of viewing macroeconomic changes as the result of exogenous shocks, Complexity Economics views macroeconomic patterns as emergent phenomenon that arise out of microeconomic interactions within the networks of the broader global economy.[31] Logically, this makes sense. Macroeconomic patterns such as depressions, booms, recessions, and inflation have existed for most of recorded history.[32] From the Tulip Bubble in Holland in the 1630s to the Financial Crisis of 2008-09, macroeconomic patterns appear to develop regardless of the technology, business practices, or economic policies of a given era.[33] This suggests that there is something inherent in economies to explain these patterns. The theory ultimately suggests that macroeconomic patterns are the result of the regular behavior of individuals within a given institutional system acting in response to changes in the surrounding environment.[34] With these characteristics in mind, this paper can now analyze congressional legislation.

II. Congressional Legislation

A. Introduction

Congressional legislation does not always succeed in achieving Congress's desired purpose. One could certainly argue that legislation often fails. Prohibition did not eliminate excessive drinking, the War on Poverty did not reduce poverty, and The New Deal did not end the Great Depression. Outside of ideological political arguments (which may or may not be correct), it is not clear why congressional legislation fails. One potential explanation may be temporal. Perhaps, legislation is most effective when Congress takes sufficient time to study an issue and extensively debate potential legislation's possible consequences. On the other hand, when Congress reacts quickly and perhaps emotionally to an event, legislation will be less

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[31] *Id.* at 167
[32] *Id.* at 161.
[33] *Id.* at 161.
[34] *Id.* at 185.

effective because Congress has not taken the time to study the proposed law's consequences. There may be something to this; however, it has one flaw. It does not take into account Congress's systematic structure as a political institution. Congressmen are elected officials with many different constituencies and are supported politically and financially by special interest organizations and individual campaign contributors. While this does not discount the altruistic aspect of public service, it recognizes that congressmen have multiple motives for pursuing policies. Thus, the more time a representative or senator has to debate and consider a policy, the more likely that his or her decision will be influenced by considerations other than the general welfare. Furthermore, congressional output is not the result of a well-oiled machine but rather an agglomeration of the individual political preferences of its members. This agglomeration of individual political choices is most aptly described as political compromise. Thus, a better answer to why congressional legislation often fails may be the recognition of a complex economy and its relationship to the inherently political Congress.

B. Complexity Economics and Public Policy

Complexity Economics takes a generally positive view of markets and views them as not only useful but necessary.[35] Without markets, there are not incentives for discovery and innovation and ultimately no evolutionary wealth.[36] Furthermore, only markets can provide the necessary feedback to determine if economic decisions are effective and efficient.[37] However, Complexity Economics also recognizes that evidence does not support a blind faith in markets.

[35] *Id.* at 423.
[36] *Id.* at 427.
[37] *Id.* at 426-27.

Stock markets are more volatile than traditional economics suggest[38], and deregulated market failures are well known if not common.[39] Thus, the state has a role to play.

However, governmental involvement in actually making economic choices is detrimental and unwise.[40] The world is too complex and interconnected. Economic acts are too unpredictable for governments, operating without market feedback mechanisms, to make appropriate choices. However, government policies that serve an "economic fitness function"[41] which create cooperation and trust and promote healthy levels of competition are encouraged.[42] Emergent phenomenon seen in the economy are the result not only of the interactions of agents but also those interactions shaped within a given institutional framework. Thus, the role of the state is "to create an institutional framework that supports the evolutionary workings of markets, strikes an effective balance between cooperation and competition, and shapes the economic fitness function to best serve the needs of society." [43] Policies that encourage the production of ethanol or fuel-efficient automobiles are frowned upon, "while contract law, consumer protection regulations, worker safety rules, and securities law" are encouraged.[44] If markets "provide the mechanism for selecting and amplifying [economic decisions], then the economic evolutionary process will innovate and adapt in response to [such] regulations."[45]

Therefore, using the above principles, one should be able to analyze the lack of effectiveness of some regulations. Unfortunately, Complexity Economics does not go far enough. Although correctly characterizing the economy as a complex adaptive system, it does

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[38] *Id. at 181-85.*
[39] *See id.* at 424 (discussing market failures in Britain's telecom and California's electricity markets).
[40] *Id.* at 426.
[41] *Id.* at 427.
[42] *Id.* at 425.
[43] *Id.* at 427.
[44] *Id.*
[45] *Id.* at 426.

not address the systematic nature of government. The institutional make-up of Congress as a political body drastically limits its ability to develop economic fitness regulations that "best serve the needs of society."[46] First, as mentioned above, congressmen do not legislate in a vacuum but rather have many motives other than the general welfare for pursuing certain policies. Further, Congress consists of 535 elected individuals. Thus, the potential motives for pursuing certain policies are enormous. Therefore, in order for a bill to gain enough votes to become law, it likely must incorporate numerous political compromises that unknowingly alter a law's potential value. Furthermore, laws must also be agreeable to the policy preferences of the President who also is operating under his own set of idiosyncratic political constraints. Thus, legislation likely will contain ambiguous requirements and appear slightly random in scope to accommodate political realities. This will be the case no matter who is in Congress as it is due to the institutional make up of the political branches of government.

Given this reality, one should expect any law that attempts to mandate specific behavior to produce unintended consequences. These laws may or may not be effective in achieving their primary purposes—see the above discussion on rent control—but they certainly will produce unintended consequences as the world is too interconnected for 535 individuals with multiple motives to comprehend all possible contingencies. Legislative failures, therefore, are likely emergent behavior of the institutional Congress. Thus, the only laws requiring or encouraging behavior that have the opportunity to be successful without producing unintended consequences are those dealing with behavior that is not connected to the broader economy—essentially operating in a closed system. Furthermore, these political and institutional constraints suggest that laws regulating the fitness environment likely will be ineffectual, incoherent, and perhaps

[46] *Id.* at 427.

detrimental as they inherently will display political motives and compromises. To see if these predictions have any support, the paper will now look at three laws passed in response to politically relevant events. Laws passed in response to major events are often clearer regarding their purpose than other legislation; thus, if the Congress's institutional make-up influences crisis laws, it is almost certain that it will influence normal, run-of-the-mill legislation.

III. Law Passed in Response to Major Events

A. The War Powers Resolution

Few constitutional issues are as important or more debated than the inter-branch distribution of war powers between Congress and the President. A cursory reading of the Constitution suggests that most war powers reside with Congress. Congress has the power to declare war, raise and support armies, provide a navy, regulate the armed forces, and to call forth the militia.[47] The president has only the designation as "commander in chief."[48] Nevertheless, since World War II, the president has exceedingly exercised an almost unilateral power to wage war.[49]

In response to the unpopular Vietnam War which began in the early 1960s, Congress attempted to reassert its authority in matters of war.[50] On November 7, 1973, Congress passed, over President Nixon's veto, the War Powers Resolution.[51] The War Powers Resolution declares that its primary purpose is to ensure that "the collective judgment of both the Congress and the President will apply to the introduction of United States Armed Forces into hostilities, or into

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[47] U.S. CONST. art. I, § 8.
[48] U.S. CONST. art II, § 2.
[49] Gareth Jamison, *The War Powers Resolution: A Congressional Failure to Act*, available at http://epress.anu.edu.au/cross_sections/cs03/pdf/ch05.pdf (last visited on May 8, 2009).
[50] J. Brian Atwood, *The War Powers Resolution in the Age of Terrorism*, 52 ST. LOUIS U. L.J. 57, 58 (2008).
[51] War Powers Resolution of 1973, Pub. L. No. 93-148 (1973); Richard F. Grimmett, *The War Powers Resolution: After Thirty-four Years*, CRS REPORT FOR CONGRESS 1 (March 10, 2008); available at: http://www.fas.org/sgp/crs/natsec/RL32267.pdf.

situations where imminent involvement in hostilities is clearly indicated by the circumstances."[52] Furthermore, this assertion of purpose states that the President can only use military force pursuant to a declaration of war, specific statutory authority, or an attack on the United States.[53]

To achieve this collective judgment, the bill's Senate sponsors introduced a version that gave the President unilateral authority to defend American forces already stationed abroad and to rescue U.S. citizens "if all other means to protect them had been exhausted."[54] All other uses of the armed forces, however, would require prior congressional approval.[55] However, a compromise bill turned these requirements into non-binding statements of purpose.[56] Instead, the enacted War Powers Resolution places three main, binding requirements on the President: to consult with Congress when possible before using force[57], to report the introduction armed forces into hostilities to Congress within 48 hours[58], and to withdraw armed forces from hostilities within 60 days if Congress has not authorized the use of force.[59]

The War Powers Resolution has failed to achieve its purpose. As of 2009, the President remains the preeminent decision maker regarding matters of war and peace. Between November 1973 and December 31, 2007, Presidents reported to Congress 123 introductions of American armed forces into hostilities.[60] The vast majority of these have been without prior congressional approval—the explicit stated purpose of the law. Well known examples include President Reagan's use of marines in Lebanon[61], President Reagan's bombing of Libya[62], President George

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[52] War Powers Resolution at § 2(a).
[53] *Id.*
[54] Atwood, *supra* note 50, at 60.
[55] *Id.*
[56] *Id.* at 61.
[57] War Powers Resolution, § 3.
[58] *Id.* at § 4(a)(1).
[59] *Id.* at § 5(b).
[60] Grimmett, *supra* note 51, at 78.
[61] Atwood, *supra* note 50, at 65-66.
[62] Jamieson, *supra* note 49.

H.W. Bush's invasion of Grenada[63], President Clinton's invasion of Haiti[64], and President Clinton's air strikes against Iraq.[65] Thus, while Presidents may technically comply with the War Powers Resolution in terms of consultation and reporting requirements, this compliance likely is due exclusively to political appearances instead of a reasserted power of Congress in war making.[66]

The reason for the failure of the War Powers Resolution appears to be consistent with this paper's predictions. The law has failed because of ambiguous and incoherent language as a result of a political compromise. The law requires consultations whenever possible before committing U.S. armed forces but does not define whenever possible or consultations.[67] Thus, presidents argue that simply informing Congress of a military operation prior to or simultaneously with the action satisfies this requirement.[68] Furthermore, the structure of the bill is incoherent given its stated purpose of increasing Congressional authority in war making. The bill allows the President to conduct wars for 60 days without any authority from Congress as long as the President lets Congress know that he has ordered such operations.[69] This incoherence was not in the original bill but became binding law due to political negotiations.[70] For whatever reason, too many congressmen were uncomfortable with imposing stringent requirements on the President.[71]

B. The 9/11 Victim Compensation Fund

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[63] Jamieson, *supra* note 49.
[64] Michael J. Glennon, *Too Far Apart: Repeal The War Powers Resolution*, 50 UNIV. MIAMI L. REV. 17, 22 (1995).
[65] Jamieson, *supra* note 49.
[66] *Id.*
[67] War Powers Resolution, § 3.
[68] Jamieson, *supra* note 49.
[69] War Powers Resolution, § 5(b)
[70] Atwood, *supra* note 50, at 60-61.
[71] *Id.*

On September 11, 2001, terrorists crashed airplanes into the World Trade Center towers in New York City, the Pentagon in Arlington, Virginia, and a Pennsylvania field. The fires had not yet stopped burning when airline industry representatives began lobbying Congress for a relief package.[72] By September 14, Representative Don Young introduced a bill to provide aid to the airlines.[73] During a subsequent committee hearing on September 19, witnesses suggested that Congress limit the airlines' tort liability.[74] This is not surprising. Within a week of the attack, America's five largest airlines announced significant flight reductions and layoffs of roughly 100,000 employees.[75] If victims on the ground or deceased victim's surviving families could prove tort negligence against the airlines[76], the resulting liability—running well into the billions—likely would have crippled the companies and had dramatic inconvenient effects on American life.

On September 20, democrats and republicans hammered out a compromise. Democrats were unwilling to agree to an airline bailout without an open-ended victim's compensation fund[77] and an extension of unemployment benefits and health insurance for laid-off airline workers.[78] Eventually, democrats dropped demands for unemployment and health benefits and republicans were able to get collateral source payments deducted from any victim payouts. The following day—only ten days after the terrorist attacks—the House and Senate passed the Air Transportation Safety and System Stabilization Act.[79]

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[72] Ronald A. Fein and Janet Cooper Alexander, *Appendix: The History and Structure of the September 11th Compensation Fund*, 53 DEPAUL L. REV. 692, 692 (2003).
[73] *Id.*; H.R. 2891, 107th Cong. (2001).
[74] Fein, *supra* note 72, at 693.
[75] Fein, *supra* note 72, at 692.
[76] This was not a foregone conclusion. Courts struggle with holding defendants liable for the intervening criminal acts of others. *See* DAVID ROBERTSON, ET AL., CASES AND MATERIALS ON TORTS 214 (3rd ed. 2004).
[77] Fein, *supra* note 72, at 694-95.
[78] Lizette Alvarez, *Washington Talk: With Bipartisan Zeal, Rival House Leaders Bond*, N.Y. TIMES, Sept. 25, 2001, at A16.
[79] Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42 (2006).

In addition to providing the airlines with access to government capital, the act created the taxpayer funded September 11th Victim Compensation Fund (the Fund) for the explicit purpose of "provid[ing] compensation to any individual (or relatives of a deceased individual) who was physically injured or killed as a result of the terrorist-related aircraft crashes of September 11, 2001."[80] Additionally, although not completely foreclosing tort claims against the airlines, the act gave potential claimants a zero-sum choice: either accept a guaranteed payout through the Fund or take a chance in tort litigation.[81] Given the uncertainty of tort litigation, almost all potential claimants chose to go through the fund.[82]

Ultimately, Congress enacted the Fund and limited tort liability to preclude the possibility of two undesirable outcomes. First, airlines, whose liability coverage was insufficient to cover the potential damages, "would be dissolved as their assets were sold to pay off their liability."[83] Second, the tort system's uncertainty likely would ensure that some if not most victims received zero compensation.[84] Broadly speaking, the law has been successful in achieving these results. The airline industry survived and victims were compensated.

The fund was completed in June 2004.[85] It paid out $7.049 billion to survivors of 2,880 persons killed in the terrorist attacks and 2,680 persons injured in the attacks.[86] The average compensation for survivors was $2 million and the average award for those injured was

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[80] *Id.* at § 403.
[81] *Id.* at § 405(c)(3)(B)(i).
[82] KENNETH R. FEINBERG, ET AL., FINAL REPORT OF THE SPECIAL MASTER FOR THE SEPTEMBER 11TH VICTIM COMPENSATION FUND OF 2001 1 (2004).
[83] 147 Cong. Rec. S9594 (daily ed. Sept. 21, 2001) (statement of Sen. McCain).
[84] *Id.*
[85] FEINBERG, *supra* note 82, at 1.
[86] *Id.*

$400,000.[87] In total, 97% of those with potential tort claims against the airlines chose to take government compensation instead of risking years of litigation.[88]

Nevertheless, the fund has generated criticism, primarily dealing with its structure and procedures. The Fund provided recovery to victims and/or their families based on a calculation of economic and noneconomic losses.[89] An Attorney General appointed Special Master administered the Fund and determined victim eligibility and specific compensation based on the calculation.[90] The federal government then paid the compensation without a budget.[91] One criticism is that the Special Master limited noneconomic losses to $250,000.[92] Many argue that this was unfair as jury awards for noneconomic losses in airline crashes typically run into the millions.[93] However, the fund was not intended to mirror tort where many victims would have been unable to recover anyway. It simply was intended to provide some compensation. Whatever criticisms exist, there is no debate that the fund achieved its purpose of aiding the airlines while providing some compensation to victims.

Furthermore, there is no evidence that the Fund negatively impacted other areas of society or the economy. Some have argued that the Fund and Congress's quick reaction suggests that compensation for future terrorist attacks will be dealt with the same way. Thus, an unintended consequence of the act is that it discourages vigilance against future terrorist attacks.[94] This does not make much sense. There has been no indication that the Fund is a blueprint for future Congressional action. Furthermore, although the fund precludes a tort

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[87] *Id.*
[88] *Id.*
[89] George L. Priest, *The Problematic Structure of the September 11TH Victim Compensation Fund*, 53 DEPAUL L. REV. 527, 529 (2003).
[90] *Id.*
[91] *Id.*
[92] *Id.* at 530.
[93] Fein, *supra* note 72, at 708.
[94] Priest, *supra* note 89, at 528.

deterrent, there are many deterrents—both economic and emotional—to guard against terrorist attacks. One strong deterrent is simply the value of human life itself. Ultimately, despite criticism, the Fund has proved relatively successful compared to much congressional legislation.

The Fund's success and its major criticisms are consistent with this paper's predictions regarding legislative effectiveness. The effectiveness and lack of incidental effects stem from the fact that creating a one-time compensation scheme for victims of the terrorist attacks likely is as close to a closed system regulation as possible. This was neither a regulation of the broader economy nor a regulation of a market connected to the broader economy. Furthermore, any future incentive effects are likely non-existent because of the one-time nature of the fund.

Furthermore, the criticisms of the Fund are consistent with its emergence from a political compromise between anti-government Republicans and pro-government aid Democrats. The resulting compensation scheme contained components of tort, market insurance, government insurance, and government welfare without any underlying rationale for its structure.[95] However, because of the law's limited scope, this apparent incoherence likely did not have a significant impact.

C. Sarbanes-Oxley

At the start of 2001, Enron, with assets over $65 billion, was the seventh largest U.S. corporation.[96] However, on November 8, 2001, Enron began restating its financial statements going back to 1997 in recognition of long running deceptive accounting practices and eventually "reduced its earnings by $1 billion, increased its debt by $2.5 billion, and squeezed its

[95] Priest, *surpa* note 89, at 532.
[96] Oleg Rezzy, Comment, *Sarbanes-Oxley: Progressive Punishment for Regressive Victimization*, 44 HOU. L. REV 95, 99 (2007).

shareholders' equity by over $3.3 billion."[97] Enron's stock collapsed and the company filed for bankruptcy protection.[98] Enron's collapse served as a catalyst for the exposure of accounting deception and the bankruptcies of major U.S. corporations like K-Mart, Global Crossing, Qwest Communications, WorldCom, and Adelphia.[99] In the following months, U.S stock markets declined considerably which most commentators attributed to a major drop in investor confidence.[100] Furthermore, investigators uncovered an illicit plan to artificially inflate Enron's stock price.[101]

This created what one could describe as a perfect storm conducive to corrective legislation. With an election upcoming in November 2002, democrats were ripe to criticize President George W. Bush—at the time historically popular—for being soft on corporate crime.[102] Republicans, while skeptical of the need for major securities reform, wanted to maintain their September 11th induced popularity in hope of gaining control of the Senate in November.[103] Thus, on July 26, 2002, [104] Congress passed the Sarbanes-Oxley Act,[105] and President Bush signed it with enthusiasm. In the name of restoring investor confidence in public companies and preventing future occurrences of accounting deception, the law "regulates lawyers, accountants, auditors, investment bankers, securities analysts, corporate directors and officers, [and] stock exchanges" associated with U.S. public corporations and foreign companies cross-listed in the United States.[106] To accomplish this, Congress crafted a law with essentially

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[97] *Id.*
[98] *Id.*
[99] *Id.* at 100-01.
[100] *Id.* at 105.
[101] *Id.* at 104.
[102] David S. Hilzenrath, Jonathon Weisman, and Jim Vandehei, *How Congress Rode a 'Storm' to Corporate Reform*, WASH. POST, July 28, 2002, at A1.
[103] *Id.*
[104] *Id.*
[105] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204.
[106] Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium*, 105 Mich. L. Rev. 1857, 1858 (2007).

five major provisions: increased internal monitoring, gatekeeper regulations, more disclosure, insider misconduct regulations, and securities analyst regulation.[107] Section 404, which imposes obligations on managers to assess internal accounting controls, is the law's most scrutinized element.[108] It requires a company's annual report to contain an internal controls report

> which shall-- (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.[109]

In addition, section 302 requires that Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) certify the accuracy of financial statements.[110]

It is not clear that Sarbanes-Oxley has achieved its goals, and it is fairly clear that the law imposes substantial unintended costs on public corporations. First, there is little evidence that Sarbanes-Oxley is effective in preventing accounting fraud. It may be but such a conclusion is difficult to measure. However, logic suggests it likely has at best a limited effect. First, financial fraud was illegal prior to Sarbanes-Oxley and violators faced both civil and criminal penalties.[111] Thus, the new requirements may not serve a substantial, additional deterrent purpose. Second, all Sarbanes-Oxley internal control requirements can be "defeated by a conspiracy among employees . . . so section 404 [is] a due diligence standard rather than an antifraud protection."[112]

Furthermore, evidence suggests the Sarbanes-Oxley has had a limited and perhaps negative effect on investor confidence. Kate Litvak has found a decline in the cross-listing

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[107] Henry N. Butler, THE SARBANES-OXLEY DEBACLE: WHAT WE'VE LEARNED; HOW TO FIX IT (2006).
[108] Sarbanes-Oxley Act, § 404
[109] *Id.*
[110] Sarbanes-Oxley Act, § 302
[111] William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private"*, 55 EMORY L.J. 141, 142 (2006).
[112] *Id.*

premium enjoyed by foreign companies subject to Sarbanes-Oxley.[113] Foreign companies typically cross-list to a foreign stock exchange to obtain greater liquidity and to align with a better corporate governance regime.[114] This typically results in increased investor confidence which translates into a higher share price, and a comparison to the lower share prices of non-cross-listed, similarly situated companies is known as the cross-listing premium.[115] Thus, a change in the regulatory scheme intended to increase investor confidence should coincide with an increase in the cross-listing premium if the change is successful.[116] However, if there is no change or a decline, it suggests that the law had no effect or perhaps actually decreased investor confidence if the premium declines.[117]

In addition to this evidence, it is undisputed that Sarbanes-Oxley has generated significant unintended consequences including opportunity costs and imposing a disproportionate burden on small firms. Sarbanes-Oxley's requirements have increased the costs of financial accounting, and these costs disproportionately affect small businesses. Firms with roughly $1 billion in assets pay an extra $1 million in audit fees attributable to the law while companies with $100 billion in assets pay an extra $ 4.5 million.[118] A company 100 times the size pays only 4.5 times the extra cost. This disproportionate impact is further supported by the fact that almost three times as many firms de-listed from public stock exchanges in 2003 as did in 2002.[119] The average de-listing company had $90 million in assets.[120] Furthermore, the opportunity costs associated with Sarbanes-Oxley are substantial. Companies are "substituting

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[113] Litvak, *supra* note 106, at 1897.
[114] *Id.* at 1861.
[115] *Id.* at 1862.
[116] *Id.* at 1862-63.
[117] *Id.*
[118] Rezzy, *supra* note 96, at 110.
[119] *Id.* at 116.
[120] *Id.*

revenue-developing employees, such as engineers [with] monitors such as lawyers and accountants."[121] Additionally, companies are being forced to engage in activities that in no way relate to the efficient allocation or productive use of resources as CEOs and CFOs are forced to expend significant time ensuring the accuracy of financial statements.[122] Companies are increasing staff meetings for the soul purpose of dealing with Sarbanes-Oxley and expending valued resources on lawyers to evaluate compliance.[123] Furthermore, director meetings are more frequent and consequently director compensation has increased.[124] These opportunity costs are hard to measure, but given the declining economic environment in which Congress enacted Sarbanes-Oxley, Congress likely did not intend to place what amounts to a cost of doing business tax on the economy.

The unintended costs of Sarbanes-Oxley are what one would expect from a law attempting to regulate economic activity. However, at first glance, Sarbanes-Oxley appears to be an economic fitness regulation. Yet, in requiring certain accounting/paperwork activities, the law forces companies to engage in unproductive activities they otherwise would not. Thus, the law is no different than a law mandating or encouraging ethanol production. Furthermore, as the result of a political compromise, the laws apparent ineffectiveness in increasing investor confidence and its likely ineffectiveness in preventing future accounting fraud is not surprising.

IV. Conclusion

The above examples illustrate both successful and unsuccessful legislation and are consistent with this paper's predictions regarding the reasons behind successful or unsuccessful legislation. The September 11th Victim Compensation Fund was broadly successful, despite

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[121] *Id.* at 111.
[122] Carney, *surpa* note 111, at 144.
[123] *Id.* at 147.
[124] Rezzy, *surpa* note 96, at 112.

some drafting incoherence, because it regulated a closed system. The War Powers Resolution has failed because political compromise created ambiguous and incoherent requirements. Finally, Sarbanes-Oxley has produced many unintended consequences because it forces companies to alter their behavior from that which is economically beneficial to that which is nothing more than paperwork due-diligence. Ultimately, there is little hope for congressional legislation under the current constitutionally mandated political structure. The world is too interconnected and Congress is too political to produce legislation that achieves its goals without producing unintended consequences. In the complex adaptive economy, there are not many closed systems like the one displayed by the September 11th Victim Compensation Fund. Perhaps, if a benevolent dictator operating without political constraints and only for the public good decreed law, laws would be more effective in achieving their primary goals. Nevertheless, the economy's interconnectedness suggests such decrees would still produce many unintended and unwanted consequences. Thus, Congress should attempt to limit its policymaking only to those areas where legislative changes are absolutely necessary and leave everything else to economic and social actors.