THE STOCK MARKET SHOULD BE MORE THAN A LOTTERY

The disconnect is considerable in our society between corporate management and control and ownership. Not only is the small stock holder more or less powerless, he or she has little, if any interest in the company whose stock she may own. As a good first approximation the stock is merely a lottery or a horse race ticket where the owner has little if any intention or ability to read several hundred pages of analysis and financial reports concerning what the corporation does. The existence of short term and long term capital gains rules helps somewhat to ameliorate the lottery ticket attitude. If an individual has to hold a stock for a year that time period is probably big enough to cause some investors to know something about the company whose stock they own. But it is not enough.

A different tax structure starting with the capital gains tax at the ordinary individual income tax level for the first year and going down to zero for holdings of seven years or more would create an important sense of identity between the individual owners and the corporations whose stocks they own. The loss in liquidity would be more than compensated for by the gain in governance. Both the individual stockholders and the mutual funds would be incentivized by individual self-interest to abandon a mentality of mark-to-market stressing the daily drawing of the “winners and losers”. They might actually start to become concerned with the balance sheet and long term management performance. The attitude towards management would change along with the concern for the real assets of the corporation. Charismatic CEOs who concentrate on short term profits would find that there is a body of stockholders with sufficient interest in the firm as an economic entity to call management actions to account.

Many of the problems of governance of the modern corporation will obviously not be solved by one simple change in the rules, but a necessary condition towards creating good corporate governance is not by loading the economy with an enormous burden of special rules and regulations, but by creating a large constituency that cares.