The New Bubbles, Tax Breaks and the Lessons Not Learned
Loopholes and Potholes on the Roadmap to Fiscal Equity and Good Corporate Governance

Soon after the stock market bubble burst and major financial and corporate scandals broke out, early in this millennium, a few of the more prudent members of the rentier class[1] in the US and Canada began to demand that instruments such as derivatives and hedge funds, subject to little or no regulatory requirements, be brought under public control, and that the ways in which CEOs manage other people's assets also be more closely regulated.

A parallel development involved stock options. American economists in the 1980s had promoted stock options as a way to improve performance of corporate management, on the theory that the change in status of the recipients of such options from *agents* of the shareholders to that of *principals* having more of a stake in results, would greatly enhance the economy. As the New Economy unravelled and the role of stock options in the growth of the capital market bubble and their relation to some of the imaginative accounting and structuring of enterprises, became known, some of the advocates of stock options had the courage to admit they had not taken into account the potential risks and perverse effects of thus rewarding top management. A study by Dr. Carmelita Troy & al., of the University of Maryland, confirms that the mix of stock options and of acquisitions is related to the numerous cases of accounting fraud that emerged in the 1990s. The stock options led CEOs and CFOs to make reckless mergers and acquisitions and to cook the books in order to raise the value of the shares .[2]

Even among business management people over 50% feel that stock options lead to insider trading crimes and that security regulators must enforce tougher insider trading legislation in order to combat corporate fraud.[3]

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[1] I use the term *rentier* in the same sense as do Hans-Peter Martin and Harald Schumann in their work *Die Globalisierungsfaille: Der Angriff auf Demokratie und Wohlstand*, Rowohlt Verlag GmbH, Reinbek bei Hamburg, 1996, translated into French and published under the title of *Le piège de la mondialisation: L'agression contre la démocratie et la prospérité,* Actes Sud, 1997. Their use of the term rentier is similar to the concept of dominant social class or capitalist class, as used by James Laxer in *The Undeclared War: Class Conflict in the Age of Cyber Capitalism,* Penguin Books, 1998.

[2] A study done at the Robert H. Smith School of Business of the University of Maryland, by Carmelita Troy, Ken G. Smith and Lawrence Gordon, to be presented at the Academy of Management annual meeting on August 1, 2003. Not yet published but press release available from Jeff Heebner:- jheebner@rsmith.umd.edu. The data is available at:- http://www.rhsmith.umd.edu/pr/secstudy03.html.

[3] Poll and analysis by COMPAS Inc., published by the National Post, July 3, 2003.

In the last couple of years, given all the texts published on the subject and all the pronouncements of public and private sector pundits on the need to restore confidence in the market, one would have expected – perhaps naively – that G7 governments would implement stricter corporate and stock exchange legislation designed to limit the issue of stock options and to regulate the marketing of hedge funds and derivatives. In fact little of substance has been done except for the adoption by the US Congress of the *Sarbanes-Oxley Act* in 2002 and the June 2003 introduction in Canada of Bill C-46 on capital market fraud, both of which appear to involve more posturing about cracking down on white collar crime than actual assertion of public control over what Galbraith has called the casino economy.

On the fiscal front nothing has been done to close loopholes in North American tax laws which have led to the creation of trust funds, or to reduce the attractiveness of stock options. ''Investors'' departing from the common share market have increasingly moved to trust funds and to hedge funds, creating two new bubbles. Some of the trust funds are based on real estate speculation. In the USA even pension funds are increasing their purchase of hedge fund units.

Alan Greenspan, US Federal Reserve Board Chairman, the man who in the 1990s characterized the stock market bubble as evidence of ''irrational exuberance'', had to call on big Wall Street players to bail out the Long Term Capital Management (''LTCM'') hedge fund in order to prevent a major financial crash. He nevertheless maintains his opposition to the regulation of derivatives – an instrument used by Enron to move liabilities offshore. Derivatives were involved in the LTCM fiasco as well as in the collapse of the Barings Bank. They are also a notorious means of money laundering and tax evasion.

Another example of contemporary laissez-faire, or more accurately, of militant corporate activism to encourage CEOs to continue to give themselves stock options (with a little help from their board of director friends), is the continued G7 habit of cutting taxation of capital gains, e.g., in the US, Germany and Canada. Paul Martin, now the leading contender for the Canadian Liberal Party leadership, when he was finance minister not only reduced the percentage of capital gains subject to income tax but he also reduced the rate at which they are assessed and postponed the point in time when the liability arises! A related problem dating back to the Reagan era was the change in the deductibility of interest from taxable income, which launched the M&A mania. Other countries followed the American example, with similar consequences. The study by Dr. Troy, mentioned above, links acquisitions and stock options with the numerous instances of accounting fraud which erupted in the last decade.

It is difficult not to perceive a bias in favour of the rentier class at play in our fiscal and public law policies. One may also wonder whether our elected and appointed officials have learned anything at all from the events of the last three years – and whether they even care about the results of market bubble bursts on the savings and retirement funds of ordinary people, or about fiscal equity and social justice.

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