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Wall Street's Dead End

By FELIX SALMON

THE stock market has been big news in recent days. Last week's report that Deutsche Börse, a giant German exchange, intends to buy the New York Stock Exchange, creating a company worth some $24 billion, arrived shortly after the Dow broke the 12,000-point barrier for the first time since before the financial crisis.

These developments drew headlines because they seemed to exemplify significant trends in the American economy. But look at America's stock exchanges more closely, and there's less to them than meets the eye. In truth, the stock market is becoming increasingly irrelevant — a trend that threatens the core principles of American capitalism.

These days a healthy stock market doesn't mean a healthy economy, as a glance at the high unemployment rate or the low labor-market participation rate will show. The Tea Party is right about one thing: What's good for Wall Street isn't necessarily good for Main Street. And the Germans aren't buying the New York Stock Exchange for its commoditized, highly competitive and ultra-low-margin stock business, but rather for its lucrative derivatives operations.

The stock market is still huge, of course: the companies listed on American exchanges are valued at more than $17 trillion, and they're not going to disappear in the foreseeable future.

But the glory days of publicly traded companies dominating the American business landscape may be over. The number of companies listed on the major domestic exchanges peaked in 1997 at more than 7,000, and it has been falling ever since. It's now down to about 4,000 companies, and given its steep downward trend will surely continue to shrink.

Nor are the remaining stocks an obvious proxy for the health of the American economy. Innovative American companies like Apple and Google may be worth hundreds of billions of dollars, but most of them don't pay dividends or employ many Americans, and their shares are essentially speculative investments for people making a bet on how we're going to live in the future.

Put another way, as the number of initial public offerings steadily declines, the stock market is becoming little more than a place for speculators and algorithms to compete over who can trade his way to the most money.

What the market is not doing so well is its core public function: allocating capital efficiently. Apple, for instance, is hugely profitable and sits on an enormous pile of cash; it is thus very unlikely to use its highly rated stock to pay for any acquisitions. It hasn't used the stock market to raise money since 1981, and there's a good bet it never will again.

Meanwhile, the companies in which people most want to invest, technology stars like Facebook and Twitter, are managing to avoid the public markets entirely by raising hundreds of millions or even billions of dollars privately. You and I can't buy into these companies; only very select institutions and well-connected individuals can. And companies prefer it that way.

A private company's stock isn't affected by the unpredictable waves of the stock market as a whole. Its chief executive can concentrate on running the company rather than answering endless questions from investors, analysts and the press.

There's much less pressure to meet quarterly earnings targets. When the stock does trade, the deals can be negotiated quietly, in private markets, rather than fall victim to short-term speculation from the high-frequency traders who populate public markets. And companies love how private markets allow them to avoid much of the regulatory burden of being public.

That burden comes largely from the Securities and Exchange Commission, which was created in the wake of the 1929 stock-market crash to protect small investors. But if the move to private markets continues, small investors aren't going to need much protection any more: they'll be able to invest in only a relative handful of companies anyway.

Only the biggest and oldest companies are happy being listed on public markets today. As a result, the stock market as a whole increasingly fails to reflect the vibrancy and heterogeneity of the broader economy. To invest in younger, smaller companies, you increasingly need to be a member of the ultra-rich elite.

At risk, then, is the shareholder democracy that America forged, slowly, over the past 50 years. Civilians, rather than plutocrats, controlled corporate America, and that relationship improved standards of living and usually kept the worst of corporate abuses in check. With America Inc. owned by its citizens, the success of American business translated into large gains in the stock portfolios of anybody who put his savings in the market over most of the postwar period.

Today, however, stock markets, once the bedrock of American capitalism, are slowly becoming a noisy sideshow that churns out increasingly meager returns. The show still gets lots of attention, but the real business of the global economy is inexorably leaving the stock market — and the vast majority of us — behind.

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