CORPORATE FINANCIALIZATION AND WORKER PROSPERITY: A BROKEN LINK

REPORT BY **LENORE PALLADINO**
JANUARY 2018

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ABOUT THE AUTHOR

Lenore Palladino is Senior Economist and Policy Counsel at the Roosevelt Institute, where she brings expertise to Roosevelt's work on inequality and finance. Lenore was most recently Vice President for Policy and Campaigns at Demos, where she built Demos's strategic campaigns department. Her research and writing focus on financial reform, financial taxation, labor rights, and fiscal crises. Her publications have appeared in *The Nation*, *The New Republic*, *State Tax Notes*, and other venues.

ACKNOWLEDGMENTS

We thank Susan R. Holmberg, Mike Konczal, J.W. Mason, and Mark Paul for their comments and insight. Roosevelt staff Nell Abernathy, Kendra Bozarth, Rakeen Mabud, Katy Milani, Jennifer R Miller, Marshall Steinbaum, Steph Sterling, Victoria Streker, and Alex Tucciarone all contributed to the project.

This report was made possible with generous support from the Ford Foundation, W.K. Kellogg Foundation, and Arca Foundation.

Executive Summary

In the era of increased financialization, the ability of workers to bargain for a greater share of firm profits has eroded. Corporate financialization—the increasing share of profits earned from *financial activity* and the increasing *flow of profits to shareholders*—is a key driver of this economic inequality. Such corporate behavior leads to the economic puzzle we see today: record corporate profits and share prices, coupled with low corporate investment and wage growth.

This paper explores the roots of corporate financialization for America's large public companies. The increased pressure from financial markets to keep share prices high and avoid hostile takeovers means that the top job of corporate executives has shifted from managing rising sales to managing rising share price. This leads not only to pressure to keep wages from rising and keep investment costs low, but also to the fissured workplace itself. The rise of shareholder primacy has meant that there is simply *less available* for employee compensation, as profit *must* flow out to shareholders and creditors. The long-term consequences for companies may be declines in skill level and difficulties in improving the productivity of labor. The long-term consequences for employees include stagnant wages. The increasing share of profit earned off of financial assets means that workers may be *needed less*, as firms make money off of financial activity rather than their traditional business. Finally, because executives have been transformed into shareholders themselves, their incentive to prioritize share price over productivity growth is personal. The scale of corporate profits going to financial uses debunks the claim that increased compensation for employees is out of reach.

In this paper, I focus on financialization in the non-financial corporate (NFC) sector of the economy, which has received comparatively less attention than the dominance of the rising financial sector. Though corporations are currently driving economic inequality, it is important to remember that corporations can, in theory, be creators of economic prosperity. America's public companies have moved away from investing in the productivity of workers by paying stable wages and rewarding skill growth and longevity, thus decreasing the innovation that they are able to produce and the profits they are able to earn. It is essential to reverse the incentives that drive corporate behavior—for workers, for firms, and for our economy. Therefore, along with policies that raise the minimum wage through legislation and improve the bargaining power of wages through unionization, it is critical to rewrite tax, corporate governance, and other public policies that have driven firms to financialize.

Introduction

The increasing *financialization* of America's large public companies has had a profound effect on labor markets. Wages are stagnant, income inequality has grown, and corporate America is no longer a provider of stable employment for middle-class workers. Common explanations include globalization, the rising power of the financial sector itself, the decline of trade union power, and skill-biased technical change. However, changes in how corporations *earn profits*, and how they *use those profits*—the two strands of behavior that I call *corporate financialization*—are key drivers of rising economic insecurity, and require further consideration.

Rising corporate profits—driven in large part by increasing market concentration—have been disproportionately captured by the wealthy rather than reinvested in the firm (Gutiérrez and Philippon 2017; Mason 2015). I define "corporate financialization" as the mechanism for such capture, specifically through the rise of two kinds of financial activities within firms. First, corporate firms are holding a rising proportion of financial assets, and, consequently, earn an increasing proportion of total profit from such assets, versus the profit that they earn from their normal business activity (Krippner 2005). Second, profits are increasingly used to drive up rising short-term share prices, and are captured by shareholders, rather than invested in labor or capital (Mason 2015). These changes mean a higher proportion of corporate cash goes to shareholders and the purchasing of financial assets, while less is available for workers and productive investment. This leads to the economic puzzle we see today: record corporate profits and share prices, coupled with low corporate investment and wage growth.

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Since firms are made up of different constituencies and allocations of profit—including employees, executives, and shareholders, as well as short- and long-term productive investment—a rising proportion of profit flowing to one set of stakeholders or uses will result in a decline in what is available for the others. The rise in firms' savings and holding of financial assets has meant firms are net lenders rather than net borrowers in a macroeconomic sense, undermining the traditional notion that the financial sector itself exists to support corporate investment. The set of public policies that have incentivized financial asset-holding and increasing financial flows to shareholders must be taken on directly in order to improve the economic security of the American people.

In this paper, I focus on financialization in the non-financial corporate (NFC) sector of the economy, which has received comparatively less attention than the dynamic of the rising financial sector. First, I describe the current state of America's public corporations and labor markets. Next, I examine the two corporate financialization flows: first, the rise of financial profits, versus profits earned off of the sales of goods and services; second, the rise of short-termism[1] and shareholder maximization. In each section, I will review some of the literature that defines these phenomena and focus on research that demonstrates the impact on wages, employment, and the fissured workplace.

Numerous researchers document the rise of financial profit-making within NFCs and examine its relationship with declining productive investment and declining labor market outcomes. Others focus on the increase of capital market pressures and ethos of shareholder value maximization. Krippner (2005), Lin et. al (2014), and L. Davis (2013) define corporate financialization as the rising ratio of financial profit earned off of financial assets, relative to business profits earned from the regular trade of the corporation. Other researchers, such as Lazonick (2014) and Mason (2015), focus on the increase of unproductive stock repurchases and dividend payments as a primary measure of the rise of shareholder maximization as the *modus operandi* of the firm. This paper combines the two lenses on corporate activity to follow the flows of profits into—and out of—the firm.

"Financial assets" in the NFC context refers to the holdings of cash and short-term investments, current receivables, advances, and a miscellaneous category of "other" financial assets. Financial asset holdings are not trivial: The *Financial Times* has documented how, in 2015, NFC financial holdings topped $2 trillion for the first time, outstripping the asset holdings of traditional Wall Street asset managers.[2] Just 30 U.S. companies have portfolios of cash, securities, and investments worth more than $1.2 trillion; holdings of corporate debt and commercial paper are at a record $432 billion, as companies avoided repatriating cash for tax purposes and instead looked for riskier investment opportunities. The *Financial Times* noted that the fact that NFCs are "pumping excess cash into bonds reinforces the depressing fact that many companies don't see attractive investment opportunities in their business lines, helping explain the lack of stronger economic activity and mediocre wage gains for workers in recent years."[3]

Before focusing entirely on the process of financialization within NFCs, it is useful to define the term "financialization" as it pertains to the entire economy.[4] The term is commonly

[1] Defined by Abernathy et al. (2016), "Short-termism is a corporate philosophy that prioritizes immediate increases in share price and payouts at the expense of long-term business investment and growth."

[2] See *Financial Times*, "Microsoft Shows How Corporate Cash Piles Blur Lines with Wall St," September, 15, 2017.

[3] See *Financial Times*, "Corporate Bondholders Heighten Market Risk," September 14, 2017.

[4] For a full discussion of the shifts in the financial sector and the impact of financialization on American culture, see Konczal and Abernathy (2015).

used to describe the rising share of profit accruing to the financial sector (as opposed to non-financial corporations) and the shift in the culture towards a market orientation.[5] Konczal and Abernathy (2015) define financialization as encompassing four core elements: savings, power, wealth, and society. They further define it as "the growth of the financial sector, its increased power over the real economy, the explosion in the power of wealth, and the reduction of all of society to the realm of finance." Epstein (2015, p. 5) describes financialization as "the increasing role of financial motives, financial markets, financial actors, and financial institutions in the operation of the domestic and international economies." Epstein and Jayadev (2005) examined the *rentier* share of national income, i.e. the rising profits of financial firms plus the interest income generated by non-financial firms and households, to describe the rise of financial sector's power in the economy. Other authors link financialization to broad macroeconomic trends of declining growth and compare the structural forces of financialization and neoliberalism.[6]

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Though corporations are currently driving economic inequality, it is important to remember that corporations can, in theory, be creators of economic prosperity. Lazonick (2013) outlines the "Theory of Innovative Enterprise," in which innovation drives the creation of higher-quality products at lower unit costs, benefitting consumers. Innovation stems from a "retain-and-reinvest" model of corporate resource allocation, in which corporations retain profit and crucially invest in the productivity of workers by paying stable wages and rewarding skill growth and longevity, *in order to* increase the innovation that they are able to produce and thus the profits they are able to earn.[7] It is due to a reliance on profits earned from improving productivity that workers are able to bargain for an increased share of profits in the form of higher wages and benefits. As will be explored below, America's firms today have moved to the other end of the spectrum from this idealized version of corporate purpose, making it essential to reverse the incentives that drive corporate behavior.

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[5] See, for example, G. Davis (2011); Epstein (2005); and Palley (2007).

[6] Palley (2008) argues that financialization may be culpable for the growth of income inequality in the United States, and that the "defining feature of financialization in the U.S. has been the increase in the volume of debt." Palley argues further that "financialization is a particular form of neoliberalism. That means neoliberalism is the driving force behind financialization and the latter cannot be understood without an understanding of the former." (See also Lapavitsas (2013); Dunhaupt (2014, p. 8) for a useful chart outlining the stylized facts in the two theoretical frameworks.)

[7] Zeynap Ton describes a similar model in *The Good Jobs Strategy*, in which she examines specific firms and how their investment in their workforce results in higher customer satisfaction, profit, and market share.

The Decline of the Public Corporation and the Rise of Economic Insecurity

The postwar era saw the rise of the corporation and the linkage of stable corporate employment with basic family needs, like a stable income, health care, and retirement, though the availability of such employment was deeply stratified by race and gender (G. Davis 2016).[8] Firms depended on a steady workforce, and unions were able to make significant gains for their members, while hired managers came to wield significant authority over the decisions of the firm. Starting in the 1980s, there have been significant shifts in the structure of large corporations and a concurrent long-term decline in employment security for workers. Though there are exceptions, the major transition that took place in the 1980s was from a corporate model, in which success ultimately rested on the growth of sales, to one that focused on maximizing returns for shareholders.

Beginning in the late 20th century, workers became the largest cost to cut in pursuit of strong capital market valuation. Gerald Davis (2016) describes how highly conglomerated firms that had been undervalued by the stock market were broken up through a wave of hostile takeovers in the 1980s. As firms became more responsive to capital market pressures and takeover threats, the labor accords of the postwar era became subject to rising cost scrutiny. By the 1990s, maximizing shareholder value had become the dominant mode for public corporations, driven by legal and regulatory shifts under the Reagan administration. Lead firms (e.g. Nike) focused on brand value over production and spun off to global suppliers, enabled by the rise of information and communication technologies (ICTs). Large-scale layoffs and rising benefits insecurity ensued—American mainstays like Sara Lee went from 154,000 to 10,000 employees in 10 years, and the computer and electronics industry as a whole lost 750,000 jobs. Since creating shareholder value was at odds with long-term, well-paid employment, employee cost-cutting became the norm and the labor market as a whole was destabilized.

By the 1990s, maximizing shareholder value had become the dominant mode for public corporations, driven by legal and regulatory shifts under the Reagan administration.

[8] See *The Vanishing American Corporation* for a full description of the shifts in public corporations over the last hundred years.

Weil (2014) documents a substantially similar process by focusing on the fissured workplace. He shows that as large corporations increasingly focused on core competencies in response to investor pressure to raise share prices, they moved a percentage of their workforce out of direct employment through subcontracting, outsourcing, or franchising. Non-professional workers were no longer considered central to firm productivity—rather, firm profit required keeping overall labor costs as cheap as possible and getting rid of all the ancillary costs of direct employment. Pressure from the financial markets caused companies to shed increasing numbers of non-core employees. This reduced the ability of workers to claim a share of any increasing profit made by the lead firm. Fundamentally, labor was shifted from "a wage setting problem into a contracting decision" (Weil 2014).[9]

Measuring the Rise of Corporate Financialization

The shifts in corporate behavior have led to an emphasis within firms on financial assets and shareholder value. But to analyze the impact of this shift on workers specifically, it is important to first measure increasing corporate financialization directly. Two types of measurements are important: first, the proportional rise of financial assets and income earned off of such assets, relative to profit earned from selling goods and services; second, the relative proportion of overall firm profit flowing to payouts to shareholders. These shifts have happened within the context of rising corporate profits, along with stagnant wages. Chen, Karabarbounis, and Neiman (2017) document two key shifts in global corporate behavior that show the rise of corporate financialization across industries and countries. First, corporate savings rose as a proportion of global savings, driven by increasing corporate profits;[10] such savings become, in a macroeconomic sense, the funds available for the rest of the economy to borrow, and corporations are now net lenders to the rest of the economy. Since corporate profits are allocated to payments to labor, capital, taxes, and savings, they show that since the labor share declined, and taxes and dividends remained steady, corporate savings rose de facto. Second, they show how this increase in savings is actually used within the firm; firms can reinvest savings in productive investment, or accumulate cash or other financial assets (one of the first indicators of increased financialization), repay debt, or increase share repurchases (the second major indicator of

9 For a full discussion of the shifts in lead firm employment, see *The Fissured Workplace*.

10 Elsewhere in their analysis they discuss the drivers of increased corporate profits: a declining real interest rate, the price of investment goods, and declining corporate taxes. They do not discuss declining bargaining power of labor.

increased financialization). They document that productive investment did not keep pace with rising corporate savings, meaning that all of the other uses of increasing savings grew as well. In other words, they conclude:

> *"Given that dividend payments and investment did not increase much as a share of value added (profits), firms used part of the increased flow of savings to repurchase their shares and part of it to accumulate cash and other types of financial assets" (Chen, Karabarbounis, and Neiman 2017, p. 37).*

In the rest of this section, I will discuss the literature that extends this analysis to the United States.

RISING FINANCIAL INCOME WITHIN NON-FINANCIAL CORPORATIONS

The first way to measure corporate financialization is to look at the increase in income that firms make from financial assets and rising financial asset-holding. Krippner (2005) presents evidence for a shifting "pattern of accumulation in which profits accrue primarily through financial channels rather than through trade or commodity production… '[f]inancial' refers to activities relating to the provision (or transfer) of liquid capital in expectation of future interest, dividends, or capital gains" (p. 174). In other words, the "lens" she uses to analyze changes in American business is to look at how *profits* are generated, rather than how employment has changed or the type of output has shifted.[11] Krippner measured the increasing ratio of *portfolio income*—income earned off of financial assets—to revenue from productive activities, looking at the total earnings accruing to NFCs from interest,[12] dividends, and realized capital gains on financial investments; and measuring revenue using corporate cash flow (profits plus depreciation allowances). She finds that the ratio began to climb in the 1970s and peaked in the 1980s at a level that was *five times* the ratio typical in the preceding decades. Notably, in the 1970s it was manufacturing firms who led the shift to relying on an increasing share of profit from financial activity (Lin and Tomaskovic-Devey 2013). Krippner also found that the rise in interest income largely drove the surge in portfolio income, whereas capital gains and dividends held steady, demonstrating that a growing stock market cannot fully explain NFC financialization.

11 Krippner (2005) characterizes this as an activity-centric (versus an accumulation-centric) view of the economy. She compares the "pictures" of the economy that emerge from the different viewpoints, showing that examining shifts in employment and output do not properly reveal the rise of financial income within "real economy" firms.

12 This is the use of corporate cash in the financial sector, loaning it out as commercial paper to earn a return.

The first way to measure corporate financialization is to look at the increase in income that firms make from financial assets and rising financial asset-holding.

Lin (2015) shows how firms shifted into holding a rising proportion of financial assets.[13] Specifically, in the 1980s and 1990s, ownership of financial assets varied with the business cycle, but since the 2000s there has been a steady rise of such ownership (Lin 2017). This ownership is highly concentrated in large firms: Just 30 U.S. companies have amassed holdings of more than $1.2 trillion worth of cash, securities, and financial investments. Roughly 70 percent is held overseas—crucially, financial investment can be conducted without bringing the profit "home" to the U.S., whereas productive investments require such repatriation and payment of U.S. corporate taxes.[14]

Krippner (2012) posits that rising financial asset-holding was initially driven in the high interest rate environment of the 1980s, when it was a bad time to be a borrower and a good time to be a lender. Corporate cash was directed towards higher-yield short-term financial assets rather than borrowing for investment purposes at extraordinarily high interest rates. The push to increase short-term returns rose with the threat of takeovers, driven by newly emboldened activist investors. In the current era, as interest rates have stayed historically low, for large firms at least, financial asset-ownership may still provide a higher return in the short-term than putting corporate cash to work where the gains require a long-term focus. The challenge is to reorient public policy, so that it rewards investment in long-term, sustainable productivity, rather than incentivizing short-term gains from financial asset-holding.

THE SHIFT TO SHAREHOLDER VALUE MAXIMIZATION

A robust literature[15] documents the second strand of corporate financialization: the dominant ideology of shareholder value maximization and related shifts in executive pay. As firms were driven by pressure from shareholders to maximize profits and share value in order to fund higher dividends and returns from selling shares, rising share price became the core concern of firm management. The rise of institutional investors and ownership by large financial institutions, such as private equity funds, drove the transition away from

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13 Financial assets can range from in-house credit cards to commercial paper and riskier assets.

14 See *Financial Times*, "U.S. Companies Transformed into 800lb Gorilla in Bond Market," September 12, 2017.

15 A review of the literature documenting this rise is beyond the scope of this paper; see, for example, Lazonick (2014); G. Davis (2015); Epstein 2015; Parenteau (2005); Appelbaum and Batt (2014); and Dallas (2012).

long-term stock holding and towards short-term stock trading. This focus on short-term outcomes distinguishes *shareholders* from *sharesellers* (Lazonick, Hopkins, and Jacobson 2015), as the focus on short-term gain hurts the very kinds of productive investment that can provide for longer-term sustainable growth of firm output.

> ***Focus on short-term outcomes distinguishes shareholders from sharesellers, as the focus on short-term gain hurts the very kinds of productive investment that can provide for longer-term sustainable growth of firm output.***

This rise in *shareholder primacy* can be seen most directly from the exponential growth in stock buybacks, in which public corporations buy back shares of their own stock on the open market, increasing their share price (as fewer shares remain) without improving their product or finding new customers (Lazonick 2014). This has the direct consequence of reducing the earnings that are retained within the firm. Before the 1970s, American corporations paid out 50 percent of profits to shareholders and retained the rest for investment. Now, shareholder payments are *90 percent* of reported profits (Lazonick 2014). Buybacks are a speculative mechanism that do not provide new productive capital to firms; instead, they raise share prices directly, rewarding the selling of stock. From 2006 to 2015, the firms that make up the S&P 500 spent *54 percent* of net income on buybacks ($3.9 trillion). This has the direct effect of benefitting shareholders who can sell stock at higher prices and the corporate executives whose pay is largely stock-based. This activity is largely confined to the largest American firms, and examples from among America's top name brands abound. Investigating McDonald's, Lazonick, Hopkins, and Jacobson (2015) show how the iconic American firm expended $29.4 billion on buybacks from 2005-2014, which equated to 67 percent of net income. McDonald's, like many firms, conducts buybacks even when the stock price is relatively high, which is a further waste of corporate cash. In 2017, Walmart announced a new $20 billion stock buyback program, following years of billion-dollar buyback investments, even as its stock was up 17 percent last year.

In the words of Lazonick (2014), "retained earnings are what allow firms to invest in both [research and development (R&D)] and returning gains to their employees, and exemplify how an 'innovative' firm operates. If retained earnings are reduced due to higher payouts to shareholders, less is left for innovation and employees." The following sections will document the impact of corporate financialization on employees and productive investment.

Financialization and Labor Markets

In the era of increased financialization, the ability of workers to bargain for a greater share of firm profits has eroded. *Corporate* financialization impacts workers in several different ways. The increased pressure from financial markets to keep share prices high and avoid hostile takeovers meant that the top job of corporate executives shifted from managing rising sales to managing rising share price. This led not only to pressure to keep wages from rising, but

> ***In the era of increased financialization, the ability of workers to bargain for a greater share of firm profits has eroded.***

to the fissured workplace itself—the push by executives to locate increasing proportions of non-professional workers outside the firm, whether through subcontracting or outsourcing. In other words, there is simply *less available* for employee compensation, as profit *must* flow out to shareholders and creditors. This has long-term consequences for companies, as it potentially leads to declines in skill level and difficulties in improving the productivity of labor, especially when higher fissuring of the workplace occurs. The increasing share of profit earned off of financial assets also means that workers may be *needed less*, as firms make money off of financial activity rather than their traditional function. Finally, because executives have been transformed into shareholders themselves, their incentive to prioritize share price over productivity growth is personal. The scale of corporate profits going to financial uses debunks the claim that increased compensation for employees is out of reach.

> ***The scale of corporate profits going to financial uses debunks the claim that increased compensation for employees is out of reach.***

Several authors look at the correlation between rising buybacks and declining wages, showing that corporate funds going to buybacks could be redeployed to rising wages (Lazonick 2015; Ruetschlin 2014). The scale is startling: As Ruetschlin shows, rather than spending $6.6 billion on stock buybacks in 2013, Walmart could have raised the wages of its 825,000 frontline employees by $5.13 *per hour* if it had chosen to invest in its workers. Lazonick (2015) shows that while McDonald's conducted the buyback program described above, McDonald's pays the 90,000 U.S. workers that it employs directly one dollar over the legal minimum wage, bringing the average wage to $9.90 per hour.

Lin (2015) documents how the rise in financial asset-holding, the substitution of corporate debt for equity, and shareholder value orientation impacts employment size, and he specifically considers the disparate effects among different occupational groups: production employees, service employees, and professional and management employees. He finds that the increase in financial assets leads to a long-run, significant decline on blue-collar production workers (whereas there is a positive effect on managerial, professional, and service employment). Lin also studies how the increased dependence on debt and its substitution for equity generates a rising pressure to pay interest before workers' claims can be considered; this behavior also raises the need to reduce the workforce during downturns, as creditors still need to be paid. His empirical investigation shows that both rising debt and the return to shareholders have long-run, negative effects on all occupational types. Interestingly, the debt ratio has a weaker impact on service employment than the blue-collar production workforce, whereas the negative effect of shareholder rewards is strongest *vis-a-vis* service employment. Lin also finds that the financialization trends themselves, and their impact on employment size, rose throughout the last few decades.

Lin & Tomaskovic-Devey (2013) investigate the impact of rising corporate financialization and income inequality, finding that increased earnings from financial activity is associated with a falling labor share, increased compensation of top executives, and increased earnings dispersion among workers. They find that:

> *"The financialization of the U.S. economy restructured social relations and income dynamics in the rest of the economy. We believe that firms' increasing reliance on financial, rather than production, income decoupled the generation of surplus from production and sales, strengthening owners' and elite workers' negotiating power against other workers. The result was an incremental exclusion of the general workforce from revenue-generating and compensation-setting processes" (p. 1).*

Notably, their research finds that financialization had a comparable impact on labor outcomes with the more common explanations for increased income inequality, including declining rates of unionization, globalization, technological change, and capital investment. Their study also conducted a counterfactual analysis, fixing the level of corporate financialization at what it was in 1970, and examining the difference between the observed and counterfactual trend. The contrast shows that financialization accounted for approximately 58 percent of the decline in labor's share between 1970 and 2008. The counterfactual showed a lesser but still positive impact on the growth of officers' share of compensation (9.6 percent) and 10.2 percent of the growth in earnings dispersion between 1970 and 2008.

The contrast shows that financialization accounted for approximately 58 percent of the decline in labor's share between 1970 and 2008.

Dunhaupt (2013) also examines the effect of both strands of corporate financialization on labor's share of income, measuring the "distributional conflict" between firms and shareholders on the one hand and wage and salary earners on the other. She uses net interest and dividend payments as a share of the capital stock of the business sector as the proxy for financialization, and finds a positive relationship between the increase of such payments and the decline of the share of wages in national income. Rising shareholder value orientation is measured as increased net interest and net dividend payments as a share of the capital stock of the business sector. She examines results for 13 countries from 1986 to 2007, and finds that the share of retained profits declined along with the labor share, while dividend and interest payments were rising—pointing to increased corporate financialization as a causal factor of the decline of the labor share. In subsequent work (Dunhaupt 2014), she ties increasing shareholder value orientation to wage dispersion, due to rising executive compensation.

Corporate Financialization and Productive Investment

Rising corporate financialization has weakened the labor market, but it has also meant that there is less firm profit available for productive investment. Several researchers document how the dramatic shift in shareholder payouts and market concentration is correlated with declining productive investment by firms. In an important pair of papers, Gutierrez and Philippon (2016, 2017) document how declining investment relative to profit began in the 2000s, largely explained by increasing market power[16] and common ownership within industries. Such firms also exhibit a disproportionate amount of short-termism and tightened corporate governance. Specifically, they find that firms that invest less, despite high profits, spend a disproportionate amount of available cash flow on stock repurchases. Investment has not fallen because profit has fallen; they show that the average ratio of net

[16] Steinbaum and Harris Bernstein (2018) define market power as the ability to skew market outcomes in a participant's own interest without creating shared value or serving the public good.

investment to net operating surplus has fallen from an average of 20 percent between 1959 and 2001 to 10 percent between 2002 and 2015 (Gutiérrez and Philippon 2016, 2017). In other words, despite available cash, "industries with less competition invest less," while governance drives buybacks over productive investment. The paper also examined other common explanations for low investment, finding explanations based on financial frictions and globalization to be less persuasive.

Mason (2015) also provides evidence of the break in the link between corporate cash flow and borrowing and productive investment, showing that since the 1980s, firms largely borrow to enrich their investors in the short-run.[17] This phenomenon reached its zenith in mid-2007, just before the financial crisis, when aggregate payouts actually exceeded aggregate investment. Mason shows a dramatic shift over time: In the 1960s and 70s, an additional dollar of earning or borrowing was associated with a 40-cent increase in investment. This ratio has been less than 10 cents of each borrowed dollar since the 1980s. At the same time, shareholder payouts nearly doubled. Mason shows that the net flow of funds from financial markets to the corporate sector did not shift before and after the Great Recession, and that the decline in investment cannot be explained by tightening credit conditions. As he explains, "finance is no longer an instrument for getting money into productive businesses, but instead for getting money out of them" (p. 3).

> ***"Finance is no longer an instrument for getting money into productive businesses, but instead for getting money out of them."***

Demonstrating the importance of productive investment in one critical industry, Lazonick (2017) examines the financialization of the pharmaceutical industry, concluding that increased financialization means that profits are not invested in potentially life-saving innovations in new drugs. Firms in the pharmaceutical sector allocate a disproportionate share of profits to share repurchase programs, enriching top executives along the way, while arguing against price regulation in the name of retaining high levels of profits to invest in innovation. He found that the 18 drug companies in the S&P 50 Index distributed 99 percent of profits to shareholders from 2006 to 2015, distributed as 50 percent buybacks and 49 percent dividends. This translates to $261 billion spent on buybacks over the decades, unevenly divided among the 18 firms. Meanwhile, investment in R&D was only 16 percent of total revenue (Lazonick et al. 2017).

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[17] Mason's work also points to the macroeconomic challenge that lower interest rates are not leading to increasing corporate investment because of the fundamental break in the chain.

Leila Davis (2013) conducted a firm-level analysis of the constraint on fixed investment[18] from increased flows to the financial sector. She defines financialization as an "increasingly complex" relationship between NFCs and the financial sector, and shows its rise through the increasing share of financial assets relative to sales and shifts in external financing (increasing indebtedness), especially for large firms, both of which lead to declining investment. Specifically, she shows that for large firms, total financial assets increased from 29.8 percent of sales in 1971 to 47.2 percent in 2011, while fixed capital declined from 52.4 percent to 43.9 percent of sales. Her firm-level data set allows for a more specific demonstration of the shifting asset mix by disaggregating different assets (cash and short-term investments current receivables, advances, and "other" financial assets), and she shows that liquid capital increased 4.2 percentage points for large firms, while "other" capital increased 8.6 percentage points. She suggests that the move into "other" financial assets held by large NFCs may reveal a shift into providing financial services, such as car loans or store credit cards (L. E. Davis 2013).

Investment decisions rely on the value of fixed investment as well as the decisions of how to finance it; both have shifted in the last several decades due to new norms of corporate governance and rising firm-level volatility.

Davis posits that it is critical to examine the purpose of increased financial profits in order to more fully understand the impact on fixed investment. Investment decisions rely on the value of fixed investment as well as the decisions of how to finance it; both have shifted in the last several decades due to new norms of corporate governance and rising firm-level volatility. She finds that rising shareholder value maximization is associated with declining fixed investment in large firms as the pressure of short-termism drives reallocation. For the largest firms, a one standard deviation increase in average industry-level repurchases is associated with a .14 standard deviation decline in investment. In contrast, she finds that "the stock of financial assets is found to have a positive and robust relationship to fixed investment in both the short-term and the long-run in most specifications" (p. 19). This is consistent with her explanation that "for given expected returns, firms hold both fixed and financial assets, and investment actually increases if the stock of financial assets rises above the desired level." Especially for large firms, the financial profit rate is positively correlated

[18] Fixed investment refers to investment in physical capital and/or assets and technology (in contrast to investments in labor and financial assets).

with investment, suggesting "large firms generate complementarities between financial profits and the non-financial components of their business that are not captured by smaller firms." This movement into rising investment as the profit rate rises shows how certain types of rising financial assets can increase demand for the firm's non-financial profits, thereby supporting, rather than hindering, fixed investment.

Orhangazi (2006) outlines a model specifying the two flows of financialization—income earned off of investment in financial assets and financial payouts—and examines each with respect to corporate investment. He tests the two effects on a large sample of firms over the three decades from 1973 to 2003. He finds, as above, that increased financial profit opportunities crowd out productive investment, as managers chase higher short-term returns, and that increased payments to shareholders decrease available internal funds, while also increasing uncertainty. As with Davis, Orhangazi finds that the negative effects from increased financial profits is mainly felt by large corporations (2006).

Policy Outcomes and Opportunities for Further Research

Multiple opportunities remain for future research connecting corporate financialization to labor markets and productive investment. It is important to consider the financialization of specific sectors and industries, especially industries, such as retail and health care, where employment is growing and is relatively low-paid: Is there evidence of rising financialization in such sectors, and what impact, if any, has it had on particular labor market outcomes? In the case of these sectors, it may be necessary to disaggregate the change in overall employment from the effects of downward pressure on wages and fissured workplaces. In other words, overall employment may grow, but employment at lead firms could fall as a result of continued pressure from financialization, and wages could continue to stagnate. Also, how does financialization influence innovation, and what impact does this phenomenon have on consumers? Future research will build on the literature above, expanding the analysis to specific sectors and new shifts in the behavior of America's public corporations. Another strand of research could focus on the effects of financialization specifically within the largest firms, because the employment effects will be different than for smaller or medium-sized entities.

It is critical to rewrite tax, corporate governance, and other public policies that have driven firms to financialize.

As the financialization of the corporate sector continues, it is critical to understand that none of these shifts are inevitable: all result from policy choices that create incentives and opportunities for firms to increasingly act as financial actors. Therefore, along with policies that raise the minimum wage through legislation and improve the bargaining power of wages through unionization, it is critical to rewrite tax, corporate governance, and other public policies that have driven firms to financialize. In forthcoming publications, we will document the opportunities available for incentivizing corporate behavior that will have the twin impacts of strengthening labor market outcomes *and* strengthening the long-run productivity of the firm. America's working families, and our future prosperity, depend on this reorientation.

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