A NEW REPORT BY THE ROOSEVELT INSTITUTE AIMS TO ESTABLISH A SOLID DEFINITION OF FINANCIALIZATION.

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EXECUTIVE SUMMARY

Finance has been the defining characteristic of the economy since the early 1980s. Its evolution has roots in our economy, laws, politics, and cultural ideology, and it influences everything from the nature of inequality to the innovative and productive capacity of the economy as a whole to the way we approach education and investment. Experts often describe the changes in this sector as "financialization," but that term can be confusing and complex.

This paper aims to establish a solid definition of financialization that can serve as the foundation for future research and advocacy. That definition includes four core elements: savings, power, wealth, and society. Put another way, financialization is 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.

Each of these four elements is essential, and together they tell a story about the way the economy has worked, and how it hasn't, over the past 35 years. This enables us to understand the daunting challenges involved in reforming the financial sector, document the influence of finance over society and the economy as a whole, and clarify how finance has compounded inequality and insecurity while creating an economy that works for fewer people.

Savings

The financial sector is responsible for taking our savings and putting it toward economically productive uses. However, this sector has grown larger, more profitable, and less efficient over the past 35 years. Its goal of providing needed capital to citizens and businesses has been forgotten amid an explosion of toxic mortgage deals and the predatory pursuit of excessive fees. Beyond wasting financial resources, the sector also draws talent and energy away from more productive fields. These changes constitute the first part of our definition of financialization.

The size of the financial sector peaked around 7.6 percent of GDP at the height of the housing bubble and, after a brief decline, returned to 7.3 percent in 2014. In addition to becoming larger, the sector has also become much more profitable, as evidenced by its increased contribution to total corporate profits. Financial sector profits grew from less than 10 percent of total corporate profits in 1950 to nearly 30 percent of total corporate profits in 2013.

Financialization is 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.

Much of this growth is from activities that should concern us all: increased trading activities rife with conflicts of interest and risky bets; unregulated shadow banking; and an explosion of household credit from 48 percent of GDP in 1980 to 99 percent of GDP in 2007.

Although it may seem arcane, the transformation of the financial sector has grave implications for us all. Financialization affects everyone who has an investment or savings account loaded with expensive fees, who lives in a neighborhood wrecked by foreclosures, or who suffered through the endless consequences of the Great Recession. The size and power of the financial sector itself, and what it does with our savings, are major concerns for everyone.

Power

Perhaps more importantly, financialization is also about the increasing control and power of finance over our productive economy and traditional businesses. This was shown most clearly with the "shareholder revolution" of the 1980s. This intellectual, ideological, and legal revolution has pushed CEOs to prioritize the transfer of cash to shareholders over regular, important investment in productive expansion, and has resulted in an economy that no longer works for everyone.

The financial sector's power over corporate decision-making affects all of us even more than more visible fees and foreclosures do. At the height of the 2007 bubble, corporations paid out 9 percent of GDP in buybacks and dividends—the highest rate of the last 70 years, and more than 1.7 times corporate earnings of that year. This has continued in the aftermath of the Great Recession, with buybacks and dividends approaching nearly 100 percent of corporate profits. These historically high payouts drain resources away from productive investment such as expanding operations and hiring more employees. Instead, firms now focus on the short-term demands of their shareholders.

Beyond investment, there are broader worries about firms that are too dominated by the short-term interests of shareholders. These dynamics increase inequality and have a negative impact on innovation. Firms only interested in shareholder returns may be less inclined to take on the long-term, risky investment in innovation that is crucial to growth. This has spillover effects on growth and wages that can create serious long-term problems for our economy. A recent economic analysis put an estimate of the growth costs of this short-term focus at around 0.1 percent each year. This also makes full employment more difficult to achieve, as the delinking of corporate investment from financing has posed a serious challenge for monetary policy.

Wealth

Wealth inequality has increased dramatically in the past 35 years, and financialization includes the ways in which our laws and regulations have been overhauled to protect and expand the interests of those earning income from their wealth at the expense of everyone else. Together, these factors dramatically redistribute power and wealth upward. They also put the less wealthy at a significant disadvantage.

WEALTH INEQUALITY

Wealth inequality has increased dramatically in the past 35 years, and financialization includes the ways in which our laws and regulations have been overhauled to protect and expand the interests of those earning income from their wealth at the expense of everyone else.

Consider examples of the federal government's support for this process from the past 15 years alone: a bankruptcy bill designed to protect creditors and Wall Street firms at the expense of debtors, including those overwhelmed by student loans; a radical reduction of dividend and capital gains taxes that benefited the wealthy without bringing any new investments; and intellectual property laws that protect the wealth of people who own the ideas that should be driving the economy and our culture forward. This is how wealth inequality happens.

More important than simply creating and expanding wealth claims, policy has prioritized wealth claims over competing claims on the economy, from labor to debtors to the public. This isn't just about increasing the power of wealth; it's about rewriting the rules of the economy to decrease the power of everyone else.

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Society

Finally, following the business professor Gerald Davis, we focus on how financialization has brought about a "portfolio society," one in which "entire categories of social life have been securitized, turned into a kind of capital" or an investment to be managed. We now view our education and labor as "human capital," and we imagine every person as a little corporation set to manage his or her own investments. In this view, public functions and responsibilities are mere services that should be run for profit or privatized, or both.

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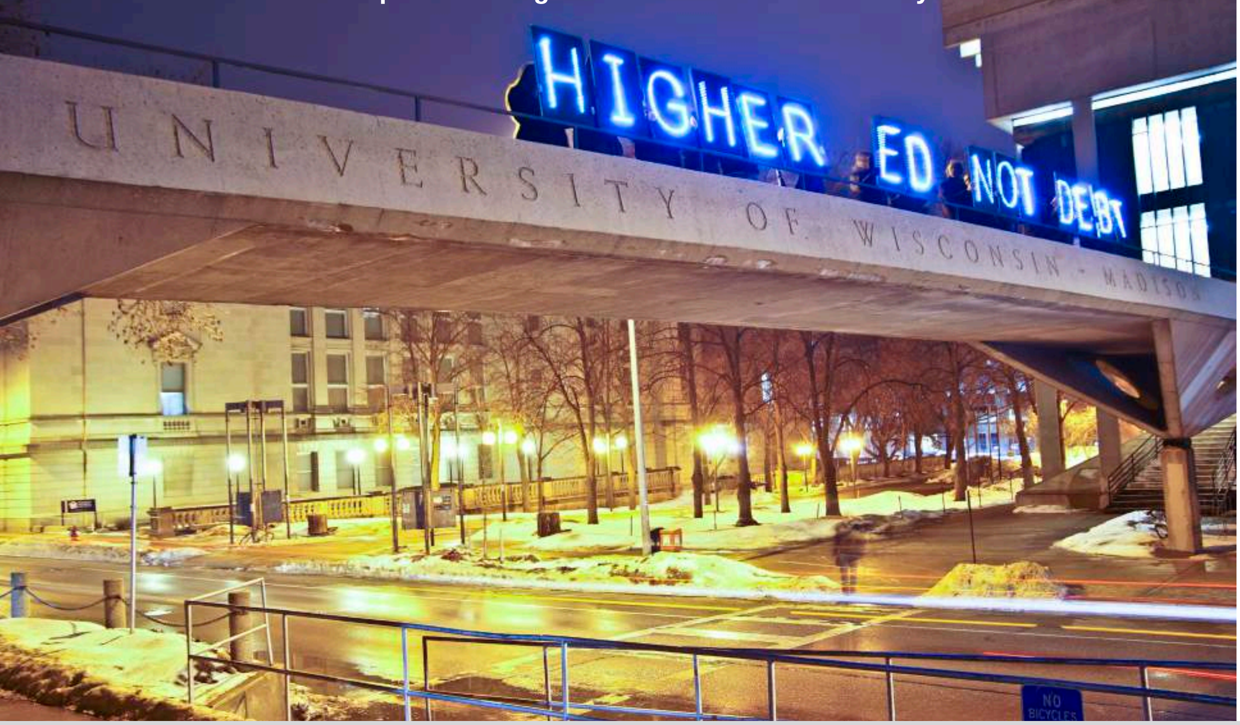
This means social insurance and other government programs are administered more through the tax code, which is regressive, as the benefits are closely linked with employment compensation or spending. Those who have jobs and get paid more or spend more also benefit more, and tend to be better equipped to take advantage of often-complicated tax planning. A privatized welfare state administered through these coupon-like mechanisms, as opposed to direct public spending, involves less compulsory risk-pooling and more individualized risk-bearing, which also tends to benefit those who are better off.

This way of thinking results in a radical reworking of society. Social insurance once provided across society is now deemphasized in favor of individual market solutions; for example, students take on an ever-increasing amount of debt to educate themselves. Public functions are increasingly privatized and paid for through fees, creating potential rent-seeking enterprises and further redistributing income and wealth upward. This inequality spiral saps our democracy and our ability to collectively address the nation's greatest problems.

Students assemble to protest rising tuition costs at the University of Wisconsin.



EXECUTICE SUMMARY

INTRODUCTION

It is impossible to understand how the U.S. economy is changing without understanding the changes taking place in the financial sector. Finance has been the defining characteristic of the economy since the early 1980s, and the evolution of the financial sector has roots in our economy, laws, politics, and cultural ideology. Changes in this sector influence everything from the nature of inequality to the innovative and productive capacity of the economy as a whole to the way we approach education and investment. The term "financialization" is used to describe these changes, though it is a term that is often confusing or too complicated to serve as the foundation for research and advocacy.

The Roosevelt Institute's Financialization Project aims to establish a solid definition of financialization and use it to build out a research and advocacy agenda. By doing this, we can understand the daunting challenges involved in reforming the financial sector, document the influence of finance over society and the economy as a whole, and clarify how finance has compounded inequality and insecurity and created an economy that works for fewer people.

After reviewing the extensive literature on this topic and conducting our own research, we believe a comprehensive definition of financialization encompasses four core elements: savings, power, wealth, and society. Put another way, financialization is 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.

Each of these four elements is essential, and together they tell a story about the way the economy has worked, and how it hasn't, over the past 35 years. This paper will explain these changes and outline future research and activism. We will begin with an overview of the individual elements.

The financial sector is responsible for taking our savings and putting it toward economically productive uses. Our definition of financialization, however, includes the realization that this sector has grown larger, more profitable, and less efficient over the past 35 years. Its goal of providing needed capital to citizens and businesses has been forgotten amid an explosion of toxic mortgage deals and the predatory pursuit of excessive fees. Beyond wasting financial resources, the sector also draws talent and energy away from more productive fields.

We believe a comprehensive definition of financialization encompasses four core elements: savings, power, wealth, and society. Put another way, financialization is 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.

Although it may seem arcane, the transformation of the financial sector has grave implications for us all. Financialization affects everyone who has an investment or savings account loaded with expensive fees, everyone who lives in a neighborhood wrecked by foreclosures, and everyone who suffered through the endless consequences of the Great Recession. The size and power of the financial sector itself, and what it does with our savings, are major concerns for everyone.

Perhaps more importantly, financialization is also about the increasing control and power of finance over our productive economy and traditional businesses. This was shown most clearly with the "shareholder revolution" of the 1980s. This intellectual, ideological, and legal revolution has pushed CEOs to prioritize the transfer of cash to shareholders over regular, important investment in productive expansion, and has resulted in an economy that no longer works for everyone.

The financial sector's power over corporate decision-making affects all of us even more than more visible fees and foreclosures do. At the height of the 2007 bubble, corporations paid out 9 percent of GDP in stock buybacks and dividends to shareholders. This is the highest rate of the last 70 years, and is more than 1.7 times corporate earnings of that year. This has continued in the aftermath of the Great Recession, with buybacks and dividends approaching nearly 100 percent of corporate profits. The added expenditure of historically high payouts drains resources away from productive investment. Instead of engaging in corporate spending aimed at expanding operations and hiring people to do the productive work that will build out our economy, firms now must focus on the short-term demands of their shareholders.

Instead of engaging in corporate spending aimed at expanding operations and hiring people to do the productive work that will build out our economy, firms now must focus on the short-term demands of their shareholders.

Financialization is also a story about wealth. Wealth inequality has increased dramatically in the past 35 years, and our laws and regulations have been overhauled to protect and expand the interests of those earning income from their wealth at the expense of everyone else. Together, these factors dramatically redistribute power and wealth upward. They also put the less-wealthy at a significant disadvantage.

Consider examples of the federal government's support for this process from the past 15 years alone: a bankruptcy bill designed to protect creditors and Wall Street firms at the expense of debtors, including those overwhelmed by student loans; a radical reduction of dividend and capital gains taxes that benefited the wealthy without bringing any new investments; and intellectual property laws that protect the wealth of people who own the ideas that should be driving the economy and our culture forward. This is how wealth inequality happens.

Finally, financialization is also a story about how we view society. Following the business professor Gerald Davis, we focus on how financialization has brought about a "portfolio society," one in which "entire categories of social life have been securitized, turned into a kind of capital" or an investment to be managed (*Davis 2009*). We now view our education and labor as "human capital," and we imagine every person as a little corporation set to manage his or her own investments. In this view, public functions and responsibilities are mere services that should be run for profit or privatized, or both.

Rather than being just an abstract concept, this way of thinking results in a radical reworking of society. Social insurance once provided across society is now deemphasized in favor of individual market solutions. Students take on an ever-increasing amount of debt to educate themselves. Public functions are increasingly privatized and paid for through fees, creating potential rent-seeking enterprises and further redistributing income and wealth upward. This inequality spiral saps our democracy and our ability to collectively address the nation's greatest problems.

SAVINGS: THE EXPANSION OF FINANCE

The financial system has gotten larger and more central to the economy. But its growth has come at a cost, with exploding inequality, decreasing efficiency, and dangerous and destructive activities.

The financial system provides four main services: the means of payment through checks and debit cards, information about investment opportunities, corporate governance, and markets for insurance. Finance also provides diversification, risk management, and liquidity. How finance does each of these things has changed dramatically as the sector has grown over the past 35 years, and there are many reasons to worry that these changes have been for the worse.

The financial sector's growth has directly increased inequality. Between 1979 and 2005, finance professionals went from being 7.7 percent of the top 1 percent of earners to 13.9 percent. Among the top 0.1 percent, finance went from 11 to 18 percent (*Bakija, Cole, and Helm* 2012). Both wages and skills in the financial sector correlate directly with the strength of financial regulation. Between the 1930s and 1980s, when financial regulations were tighter on prices and firm structure, wages and skills were lower in the financial sector. Now, with many of these restrictions removed between 1980 and 2000, both have exploded. However, skills alone can't explain the premium finance workers are paid relative to other fields. Some estimate 30–50 percent of the sector's wage boost since the mid-1980s reflects economic rents, meaning income that does not derive from skills or risks (*Phillipon and Reshef* 2008). So we can't understand inequality without understanding the financial sector.

The financial sector has grown not only in absolute size but also relative to the economy as a whole. And while it has grown, so has its profitability. That could be a good development, but during the same period the financial sector has grown less efficient at carrying out its basic tasks. Meanwhile, the activities it has engaged in have become more worrying, the sector has become more concentrated, and the activities and focus of finance have become more important in the non-financial business sector. All of these factors, taken together, mean that we also can't understand the new economy as a whole without understanding the financial sector.

Charging Bull is a bronze sculpture, originally guerilla art, by Arturo Di Modica that stands in Bowling Green Park in the Financial District in Manhattan, New York City.

Size

Let's first look at the size of the financial sector. Figure 1.1 shows the size of the financial services industry as a percentage of Gross Domestic Product (GDP) from 1950 onward. (These and future numbers exclude profits from the Federal Reserve.) As we can see, the industry has grown steadily throughout the entire period. Financial services comprised 6.6 percent of GDP in 2012, up from 2.8 percent in 1950 and 4.9 percent in 1980.

Though the financial sector's growth appears to be on a relatively smooth upward curve, the annual percent change doubled after 1980. Finance's share of GDP grew by 0.13 percent annually from 1980 to 2007, nearly double the 0.07 percent annual growth exhibited from 1950 to 1980. Many commentators have noted that the financial sector is smaller than it was before the crisis, and this is true. But though the size of the financial sector fell to 6.6 percent in 2012 after peaking around 7.6 percent of GDP during the height of the housing bubble, it returned to 7.3 percent in 2014.

Many note that services as a whole have grown during this time period, and while this is true, the financial sector has grown faster. Even as the service sector's share of GDP has increased over the last three decades, finance's share of service GDP has also increased, contributing to a quarter of overall growth in the service sector (Phillipon and Reshef 2008). By any account, the financial sector has gotten a lot larger.

Profitability

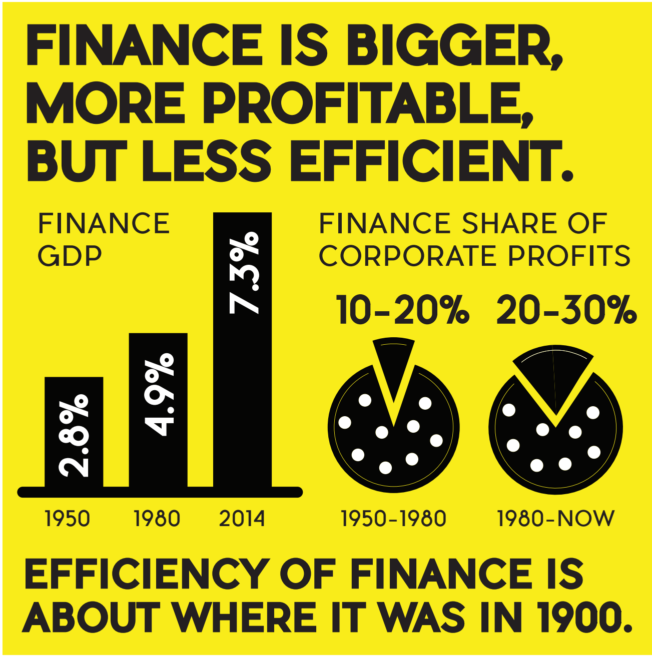
In addition to becoming larger, the financial sector has also become much more profitable, as evidenced by its increased contribution to total corporate profits. Figure 1.2 shows financial sector profits going back to 1950. Financial sector profits grew from less than 10 percent of total corporate profits in 1950 to nearly 30 percent of total corporate profits in 2013. Again, we can chart two distinct periods: From 1950 to 1980, financial profits hovered between 10 and 20 percent of total corporate profits, while after 1980, finance generated between 20 and 30 percent of total corporate profits. This relationship is true whether we look at domestic profits or worldwide corporate profits.

It's important to emphasize that this change is not just a function of changes in the profitability of other corporate sectors. While financial and non-financial profits grew at roughly the same rate before 1980, financial sector profits have grown faster than either GDP or profits as a whole since then. Between 1980 and 2006, while the GDP grew five times larger and non-financial profits grew seven times larger, financial profits grew 16 times larger.

The Efficiency of Finance

A well-functioning financial system would allocate capital to the most productive uses, reduce economic risk, and provide price-setting information. Over time, with technical and product innovation, one would expect the financial industry to do more for less. But in fact, we have seen the opposite: The economy is devoting more resources to the financial system and getting less productive allocation of credit, increased macroeconomic risk, and no observed price-setting improvements.

Despite reduced financial regulation, improved information technology, innovative financial securities, and hedging products, the per-unit cost of financial intermediation has not declined since the 1970s. According to the analysis of economist Thomas Phillipon, several key financial variables have had U-shaped curves over the course of the 20th century. The income of financial intermediaries went from 2 percent to 6 percent between 1880 and 1930 before falling during the midcentury period. Their income then grew to 5 percent by 1980 and took off after that.



SAVINGS: THE EXPANSION OF FINACE

There's a similar curve when it comes to the efficiency of the financial sector. Phillipon takes the income of the financial industry and divides it by the quantity of intermediated financial assets to get the cost of creating and maintaining all the financial assets in the economy. This unit cost of finance is between 1.5 percent and 2 percent throughout the past 130 years. Crucially, it has increased since the 1970s. Even with technical adjustments for the quality of the loans, the unit cost of finance is about as high as it was in 1900. There have been no efficiency gains in the financial sector; if anything, there have been efficiency losses since the 1970s (*Phillipon* 2012).

The economic assumption is that the financial sector's increased fees, payments, and share of GDP are due to asset managers and credit intermediaries providing more value in exchange. The evidence suggests this is not the case.

Fee Growth and Credit Intermediation

According to research by Harvard Business School professors Robin Greenwood and David Scharfstein, fees from asset management and originating household loans, as an element of credit intermediation, are the two crucial growth drivers of the financial industry from 1980 to 2007. Insurance, by contrast, did not accelerate in growth during this time period, though it is traditionally thought of as a third major function of the financial sector. Using data from the Bureau of Economic Analysis (BEA), Greenwood and Scharfstein conclude that fees from asset management and credit intermediation are responsible for 74 percent of the industry's increase in output relative to GDP.

Asset management here includes investment advisory and management, mutual and pension fund management, and trust services. What drove the increase in asset management fees? From 1980 to 1999, revenues grew because of traditional asset management; the industry continued to grow after that because of alternative asset management such as venture capital, private equity, and hedge funds. During this period, the size of financial assets grew quickly—much more quickly than GDP. The total value of mutual funds, for instance, rose from $134 billion in 1980 to $12 trillion in 2007.

So one reason for the quickness in fee growth is a simple algebraic equation: growth in total assets under management multiplied by a constant management fee. The average percentage fee on these alternative asset funds remained essentially constant as the funds grew, mechanically driving up the total fees. However, economic theory dictates that fees should decline with an increase in scale, and the failure of these fees to do so has presented a puzzle to financial academics of many stripes. Note that fees on traditional management vehicles such as mutual funds did decline as the industry grew, falling from about 2.19 percent to 1 percent of assets from 1980 to 2007. Average asset management fees remain high due to the outsized fees charged by alternative investment vehicles, which comprise between 3 and 5 percent of assets under management. According to Greenwood and Scharfstein's analysis, this accounts for 36 percent of the growth of the financial sector.

Recent changes to this field brought about by the Dodd-Frank financial reform law have revealed additional problems. Dodd-Frank requires private equity to register with the Securities and Exchange Commission (SEC) for the first time. After examining how fees and expenses were handled by private equity fund advisers in 150 cases, the SEC reported that it had identified what it believed to be "violations of law or material weaknesses in controls over 50 percent of the time" (Bowden 2014).

The second major shift in activities was among credit intermediation firms, which, according to the BEA, produce the largest share of finance output. This sub-industry accounts for 38 percent of the growth of finance, and has contributed to more than half of the financial sector's output since the mid-1980s. Growth has been less pronounced than in the securities industry, which has seen its share of GDP rise from 2.4 percent in 1980 to peak at 3.7 percent in 2002, falling back below 3 percent in the wake of the financial crisis; however, the industry's moderate growth belies deep changes in its lending structure. Those changes represent a significant shift in the banking business model toward an "originate-to-distribute" model that generates revenue by making loans and promptly

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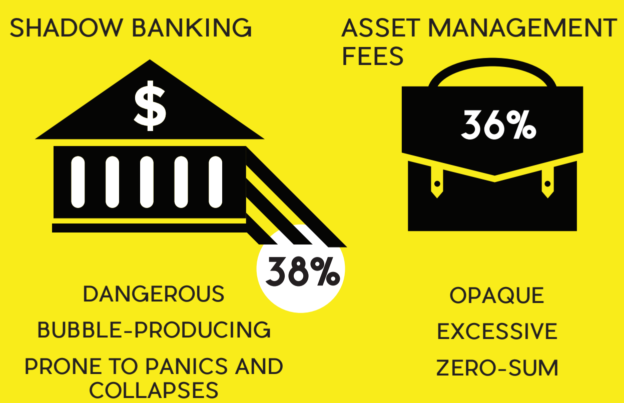
selling the claims to a third party (*Greenwood and Scharfstein 2012*).

While banks' interest income from traditional activities stagnated or declined, revenue from fees increased between 1980 and 2007. Fees associated with household credit grew from 1.1 percent of GDP in 1980 to 3.4 percent of GDP in 2007. Data on bank holding companies shows that non-interest income as a share of total financial sector revenue rose from 15 percent in 1986 to 38 percent in 2003. In the wake of the financial crisis, non-interest income hit a peak of 43 percent of total revenues (Levina 2014).

Credit intermediation has increasingly been focused on mortgages. Across 17 advanced economies, mortgage lending was close to 60 percent of all commercial bank lending in 2007, up from 35 percent in 1970. Corporations have found financing in commercial paper and equities markets; the real losers are small businesses, which are the primary source of job creation in the U.S. Small business loans as a share of total bank loans declined from 50 percent in 1995 to 30 percent in 2012 (*Jorda 2014*). Mortgage origination fees rose from 0.14 percent of GDP in 1997 to 0.72 percent in 2002, while total household credit exploded from 48 percent of GDP in 1980 to 99 percent of GDP in 2007. Meanwhile, the share of household credit on bank balance sheets remained relatively flat at 40 percent of GDP over the period (*Greenwood and Scharfstein 2012*). The risk was instead channeled to a shadow banking sector.

FINANCE GREW THROUGH THROUGH QUESTIONABLE FEES, DANGEROUS SHADOW BANKING.



Shadow Banking

This credit intermediation system was based around what economists call a shadow banking sector. Shadow banking differs from commercial banking in several important ways. The first is that the series of steps between the saver and the borrower is lengthened, and these steps are much less transparent and much more complex. This credit is also market-mediated, which means that those originating the loans will often not ultimately hold the risk of those loans. Shadow banking may involve traditional banks, but it also involves many unregulated non-banks functioning as banks. Another difference is that shadow banking uses collateral more extensively as a backstop in place of the traditional backstop of FDIC insurance or lender-of-last-resort banking that we see in the traditional banking sector. This lack of regulation and access to the traditional banking sector is what makes it a "shadow" banking sector. However, it is like the traditional banking sector in that it provides maturity transformation, which means that it uses short-term funding to process long-term loans and liquidity (Stanley 2013).

When shadow banking is described this way, two major problems are immediately apparent. The first is that the length of credit intermediation means fraud and other conflicts of interest can be introduced throughout the process (Stiglitz 2010). Indeed, empirical work shows that income was overstated in areas that featured the strongest mortgage credit growth in the build-up of the housing bubble (*Mian and Sufi 2015*). Another is that when there is a panic, the normal failsafes of deposit insurance or a lender-of-last-resort function are not there keep this sector from collapsing (*Gorton 2010*). Both of these problems manifested in the housing bubble and financial crisis of the 2000s.

Another problem is that the long credit intermediation process makes the system very brittle when it comes to correcting mistakes, particularly writing down bad loans. Since the housing bubble began to burst, the various intermediaries, known as servicers, who process payments along this chain have conflicted with the interests of bondholders over writing down bad loans, which has given rise to concerns that the servicers might prefer mortgages to stay defaulted in order to gain more fee income. These servicers are incentivized

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to increase costs at the expense of borrowers and investors, to drag out the default process, and to reduce interest rates rather than principal, even though these actions raise the likelihood of default and losses (*Levitin and Twomey 2011*).

Concentration, Costs, and Inequality

There are many other reasons to be worried about the growth of the financial sector, which has become far more concentrated. As the Dallas Fed observes, the top five banks in 1970 held 17 percent of aggregate bank assets, but by 2010, they held 52 percent (*Rosenblaum 2011*).

One risk is that the sheer size of the largest firms means that it will be more difficult to resolve them in an orderly fashion if they become insolvent. These banks hold a potentially dangerous amount of market power. Empirical work has found that this concentration has given some monopoly power to larger banks (*Kahn and Santos 2005*). Evidence suggests that banks were able to capture some of the ability of underwater homeowners to refinance their loans in the Great Recession, when refinancing was meant to boost deleveraging, solvency, and overall demand (*Fuster et al. 2012*). There's also concern about political power, as there are fewer types of industries putting competitive pressure on each other's activities, especially given the consolidation of business lines. And there are many additional activities in the financial sector not mentioned here that should cause concern. Many researchers argue that high-frequency traders, for instance, simply profit off the liquidity provided by others in the financial markets (*Budish, Cramton, and Shin 2015*).

Economists are near unanimous in agreement that a growing financial sector is key to economic development and growth. However, a new line of research argues that beyond a certain size, the financial markets don't help, and perhaps even hurt, economic growth. Stephen Cecchetti and Enisse Kharroubi of the Bank for International Settlement analyzed 50 countries from 1980 to 2007 and conclude that the size of the financial sector (defined as the ratio of private credit from banks to GDP) is associated with positive productivity growth (defined as GDP per worker) up to about 90 percent of GDP. Beyond that, problems become apparent. Specifically, they identify a causal relationship between financial sector employment and slower growth. They also argue that finance disproportionately benefits projects with low productivity and takes skilled workers away from other industries (*Cecchetti and Kharroubi 2012; 2015*).

The fact that the profitability of finance also attracts top talent away other fields has become a major concern since the financial crisis. In 2007, almost 70 percent of Harvard seniors went to Wall Street. Though this fell after the crisis, it is back on the rise, with 31 percent of the graduating class of 2014 taking jobs in finance (*Binder 2014*). The prestige and profitability of Wall Street may be attracting talent and skills better suited for research and entrepreneurship.

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The Financialization of Non-Financial Corporations

Another important issue is the impact of financial corporations on non-financial corporations. The impact on corporate finance and management will be discussed alongside the shareholder revolution in a later section. But non-financial corporations have also begun to emulate and adopt the techniques and business lines of the financial sector. With finance generating more income, non-financial corporations have expanded financial operations.

For years, the business press has highlighted examples of America's industrial giants profiting from lending.

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General Electric (GE) provides a prime example, as GE Capital generates more than 50 percent of the parent company's profits. While GE CEO Jeffrey Immelt is taking steps, including the sale of GE Capital's North American consumer lending operations, to reduce reliance on the subsidiary for profits, GE's financial arm generated 43 percent of company earnings in the second quarter of 2014. As a single entity, GE Capital would be the fifth largest commercial bank in the country.

Quantifying the aggregate trend is a greater challenge. Greta Krippner, a University of Michigan sociologist, has tracked the trend by comparing portfolio income to cash flows in non-financial corporations. Non-financial corporations are increasingly earning profits through financial channels, as opposed to the trade or production channels one might expect. To measure the value of financial earnings for non-financial firms, Krippner compares the ratio of portfolio income to corporate cash flow. Portfolio income includes non-financial corporate earnings from dividends, interest, and realized capital gains. Analysis reveals financial revenues stable at slightly less than 10 percent from 1950 to 1970. However, by the end of the '70s, financial revenues contributed about 20 percent to corporate profits, and by the end of the '80s, that share had doubled again to more than 40 percent. Breaking out portfolio income by category, Krippner finds the bulk of growth comes from rising interest income. The two peaks in financial income as a share of total income are in 2000 at 43 percent and in 2005 at 45 percent (Krippner 2011).

Solutions

The financial markets' problems evolved over 30 years, and fixing them won't be easy. However, an important element of the solution is returning to the more traditional banking sector of the mid-century period—not simply the specific mechanisms of that time, but the values they represented. Doing this will mean addressing the specific ways in which finance has grown.

The first step is to bring as much transparency, accountability, and price competition to the asset management business as possible. Registering alternative investment firms like hedge funds, private equity, and venture capital with the SEC is just a start. There should be public information on their fees and charges, as well as their returns and terms. This would help contain conflicts of interests and excessive rents through the process of competition. Continuing in this vein, there need to be proper fiduciary requirements for those who interact with consumers over financial products.

Public solutions should be considered alongside private regulations. Postal banking has a long history in the United States, and a strong public role in providing private banking options is already a part of Social

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Security through the program known as Direct Express. An expansion of Social Security or a public 401(k) would bring more retirement security while also checking the expansion of financialization.

Credit intermediation is a broken system, and it isn't clear it can be fixed. Private mortgage securitization remains at incredibly low levels, even after the Dodd-Frank reforms have become clearer. A public role in mortgage financing needs to be part of the discussion; this was the role that changed the most in the past 40 years, and the conflicts and chaos those changes generated go far beyond any conceivable benefits.

Finally, targeted changes will need to be continued and defended in areas ranging from derivatives trading to issues like Too Big To Fail. But the key goal of Dodd-Frank isn't just to fix technical problems; it's to change the culture of finance. Emphasizing transparency, accountability, and competition is the right way to proceed.

SAVINGS: THE EXPANSION OF FINACE

POWER: THE SHAREHOLDER REVOLUTION

Beyond the growth of the financial sector itself, the way the finance industry has come to dominate the priorities and thinking of the real economy as a whole is a major feature of financialization. A key aspect of this is the rise of the shareholder primacy model of corporate governance. The current belief that corporations exist solely to maximize shareholder value is the product of an ideological, legal, and institutional revolution that resulted, among other consequences, in the reallocation of corporate funds away from investment and toward payouts to stockholders. This has led to a situation in which the purpose of finance is less about getting money into productive enterprises and more about getting money out of them.

The shareholder primacy ideology, best voiced by economist Michael Jensen, was a revolt against the manager-controlled corporate governance model that dominated in post-war America. Prior to the 1970s, corporate shareholders could expect a limited return on their equity investment about equal to the risk premium, or 1–2 percent of total assets. The explicit goal of shareholder primacy advocates was to return a greater share of corporate profits to stockholders. The revolutionaries were successful in their efforts to correct the "unproductive expenditure" of corporate managers; this victory, however, has had consequences beyond the corporate boardroom. The primacy of shareholders and resulting short-termism of corporate management has directly affected U.S. economic inequality and economic growth. Net private nonresidential investment as a share of GDP hit a historic low in 1990, then a deeper trough in 2009. Median incomes have stagnated since the 1970s, even as productivity and corporate profits have risen. Meanwhile, shareholders, the owners of capital, are taking home a greater share of national income than at any point in the last century, and wealth inequality continues to increase. Examining these connections is essential to any understanding of the current economy and inequality.

The explicit goal of shareholder primacy advocates was to return a greater share of corporate profits to stockholders. The revolutionaries were successful in their efforts to correct the "unproductive expenditure" of corporate managers; this victory, however, has had consequences beyond the corporate boardroom.

The Changing Role of Managers

Corporate governance is ultimately about who makes decisions for the firm and whom these decisions are designed to benefit. In the early days of corporations, the owners ran the show. Evolving from a model in which owners and managers were one and the same, managers served primarily as agents of the corporate owners through the late 1800s and early 1900s. The combined forces of Progressive Era reforms and the Great Depression reduced the power of shareholders and gave rise to "managerialism," a system in which professional managers operate somewhat autonomously from shareholders, often with the goal of ensuring the firm's long-term growth and stability as opposed to maximizing profitability.

The primacy of shareholders and resulting short-termism of corporate management has directly affected U.S. economic inequality and economic growth.

In post-World War II America, managerialism thrived. Until the 1980s, the corporate governance regime led to a fairly predictable model of firm behavior. First, shareholders received a steady return on capital equal to the risk premium, but they were not entitled to additional payouts. Rather, the corporation's primary responsibility was to stakeholders, including customers, suppliers, and workers. Second, free cash flows provided managers with below market rate funds, which were directed toward internal purposes, largely to finance capital investment. Finally, corporate debt remained limited.

By contrast, the shareholder-dominated corporation of today pursues a single goal—profit maximization—and thus displays an entirely different set of traits. First, quite obviously, the shareholder replaces the stakeholder as a claimant on corporate surplus. Second, corporate cash flow is directed to shareholder payouts as opposed to corporate investment. Finally, corporations take on increased debt under the assumption that debt will discipline managers into following the will of financial markets. The obvious distinction between the two models is the return promised to shareholders. Shareholders have no obvious claim on corporate profits under managerial capitalism.

General Electric is again an excellent example of this transformation. As Owen Young, the GE CEO between the World Wars, said, "the stockholders are confined to a maximum return equivalent to a risk premium. The remaining profit stays in the enterprise, is paid out in higher wages, or is passed on to the customer." Indeed, until 1980, dividend payouts remained at a stable 1–2 percent of total assets. That changed under Young's successor at GE, Jack Welch, who "regarded the shareholder as king—the residual claimant, entitled to the [whole] pot of earnings," and believed employees had no claim on the company at all (*Davis* 2009).

POWER: THE SHAREHOLDER REVOLUTION

Methods of the Shareholder Revolution

From JW Mason's Disgorge the Cash (2015)

As a legal manner, it is false to say that shareholders own a company: Companies own themselves (Stout 2012). So how did shareholder primacy become not only common sense but a reality of our economic rules? Advocates of this model clearly succeeded in the effort to transform corporate governance. J.W. Mason explains that there were four major components of this transformation (2015).

INTELLECTUAL

The idea that corporations exist solely to maximize shareholder wealth is as old as the corporation itself, and, in the early part of the 20th century, it was accepted legal and economic doctrine. But it largely receded from view during the middle of the century. The idea that the stock market could enforce this principle by offering a "market for corporate control" was reintroduced by Manne (1965), but it initially had little impact on either the theory or practice of corporate governance. It was the work of Jensen and coauthors that popularized takeovers and restructurings as tools for compelling management to put the interests of shareholders above those of other corporate stakeholders (*Jensen 1986, 1993, 2000; Jensen and Meckling 1976*). Over time, the ideas that shareholders are substantively the owners of the corporation, that maximizing returns to shareholders is the only function of the corporation, and that pursuit of other goals by management is a serious problem that needs to be solved by appropriate institutions, including a market for corporate control, came to dominate much economic and legal thinking about corporate governance.

LEGAL

A number of legislative and administrative reforms made it more feasible for shareholders to assert their notional power over management. Among these were legal challenges to laws limiting hostile takeovers of corporations, including the Supreme Court's 1982 decision in Edgar v. MITE striking down Illinois's anti-takeover law and similar laws in other states (*Davis 2009*). Also important was the revision of anti-trust regulations by the Reagan Justice Department, also in 1982, which relaxed the limits on concentration within industries. This opened up new possibilities for intra-industry mergers and undermined the logic of conglomerates, the major initial target of hostile takeovers (*Roe 1996*).

INSTITUTIONAL

As discussed below, financial market changes made takeovers and other changes of control more feasible. One dimension of this shift was a broadening of the funds available to finance changes in corporate control as the rules on the classes of investments permissible by various institutions funds were progressively relaxed, starting with pension funds in the 1970s and savings and loan associations in the early 1980s (*Lazonick 2008*). Then the generalization of stock options and related compensation practices, plus much greater inter-firm mobility of top management, changed the incentives and worldview of top executives to be closer to that of shareholders.

IDEOLOGICAL

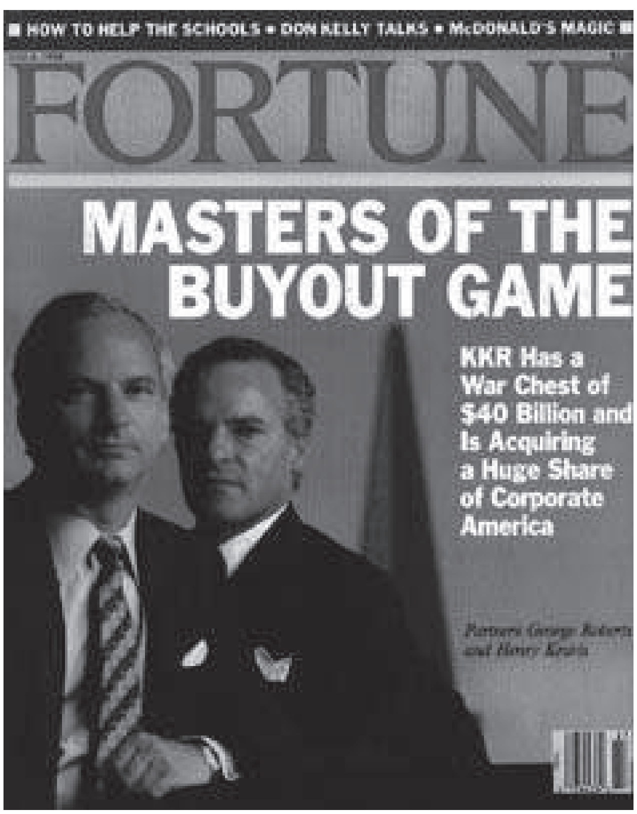
The idea that the creation of shareholder value is the sole purpose of corporations, and of economic life in general, has been widely adopted in the business press and culture at large. At the same time, there has been a decline in the idea of the corporation as a social organism or institution with an autonomous social purpose and with stable relationships with its employees, customers and suppliers, and communities where it operates. Indeed, this shift has extended beyond the corporation throughout social life. The breadth of this vision suggests that America is becoming a "portfolio society" dominated by the "capital fiction," in which all social relationships are evaluated as income-yielding assets (*Davis 2009*).

Tools of the Shareholder Revolution

As described above, the shareholder value movement gave rise to the concept of a market for corporate control. This market needed to be created by government regulations. Shareholders then fought to dominate that market with a combination of corporate "carrots and sticks." Initially, the "sticks" were hostile battles, specifically leveraged buyouts or shareholder activism. By the mid-1990s, shareholders had successfully secured management as an ally, largely through the "carrot" of performance-based CEO pay.

TAKEOVERS

The central mechanism in the first stage was the hostile takeover. The takeover movement was one of the essential economic developments of the 1980s, leading to changes in ownership—and often the outright disappearance—of a greater proportion of American corporations than in any comparable period except for the two great merger waves of the turn of the 20th century and the 1960s. Unlike during those waves, the management of the companies being acquired opposed a large share of the acquisitions in the 1980s.



Half of all U.S. corporations in the 1980s were the objects of takeover bids. In several years, over 10 percent of total stock market capitalization was purchased in acquisitions, an extremely high proportion by historical standards (*Holmstrom and Kaplan 2001*). Twenty-eight percent of Fortune 500 companies were the object of takeover attempts, the majority hostile and successful (*Davis 2009*). Those involved explicitly described these takeovers as a way for owners of financial assets to "discipline" the professional managers of the corporations (*Scharfstein 1988*).

The era of hostile takeovers did not extend past the 1980s; KKR's takeover of RJR Nabisco was the last major deal of its kind. By the mid-1990s, only 5 percent of tender offers were contested, compared with as many as 40 percent a decade earlier (*Holmstrom and Kaplan 2001*). The decline of the hostile takeover was the result of both the declining performance of these deals in the later 1980s and a less favorable legal and regulatory environment, symbolized by Michael Milken's conviction for securities fraud in 1990. By the end of the 1980s, more than 40 states had passed new anti-takeover laws. In Delaware, where a majority of large American corporations are incorporated, the state Supreme Court ruled in Paramount Communications v. Time Inc. that boards had broad latitude to refuse a takeover offer. Twenty-nine other states explicitly granted boards this authority by state law (*Blair 1993*).

The disciplinary aspect of the relationship between wealth-holders, or rentiers, and management was thereafter more likely to take the form of shareholder activism, which entails large outsider investors publicly pressuring management to increase payouts and adopt "value-enhancing" policies as well as pushing for seats on the board, sponsoring resolutions, and threatening to sell their shares en masse. Coordination between activist shareholders was significantly eased by a 1992 SEC rule change that eliminated onerous disclosure requirements for communication between shareholders (*Holmstrom and Kaplan 2003*). Combined with behind-the-scenes pressure, this kind of shareholder activism acted as a nontrivial constraint on managerial autonomy (*Henwood 1998*).

POWER: THE SHAREHOLDER REVOLUTION

Initially, public pension funds were the leaders in this form of rentier activism, along with a few individual activist investors. But other classes of institutional investors have since adopted the tactic of acquiring large stakes in corporations, then using them to pressure management into adopting more shareholder-friendly policies. Hedge funds, for example, made only 10 13D filings in 1994, the first year for which records are available. 13Ds are the legally required disclosures investors must file with the SEC when they acquire a stake of 5 percent or more in a publicly traded corporation. In 2007, hedge fund 13D filings peaked at 272 (*Bebchuk 2013*).

Given that leveraged buyouts did not, as early advocates had predicted, herald a shift away from the corporate form, but were instead a device to redistribute claims on a firm whose legal and organizational structure remained essentially unchanged, simply switching the personnel at the top was a more straightforward way of reorienting the firm toward shareholder value than the more disruptive process of changing ownership (*Bhagat, Shleifer, and Vishny 1990*).

CEO PAY

Increasingly after 1990, the adversarial relationship between shareholders and managers was replaced by acceptance of maximizing shareholder value as "holy writ" by managers themselves (*Davis 2009*). By 1997, the repudiation of managerialism was sufficiently thorough for the Business Roundtable—which represents the CEOs of the 200 largest American companies—to change its position on business objectives, after years of opposition, to read "the paramount duty of management and the board is to the shareholder and not to...other stakeholders" (Holmstrom and Kaplan 2003).

One reason for this reorientation of management priorities was the change in executive compensation practices that began in the 1980s but came into its own in the 1990s. Providing CEOs of non-financial corporations with enormous pay packages largely dependent on stock prices successfully aligned the managers' interests with the interests of the shareholders.

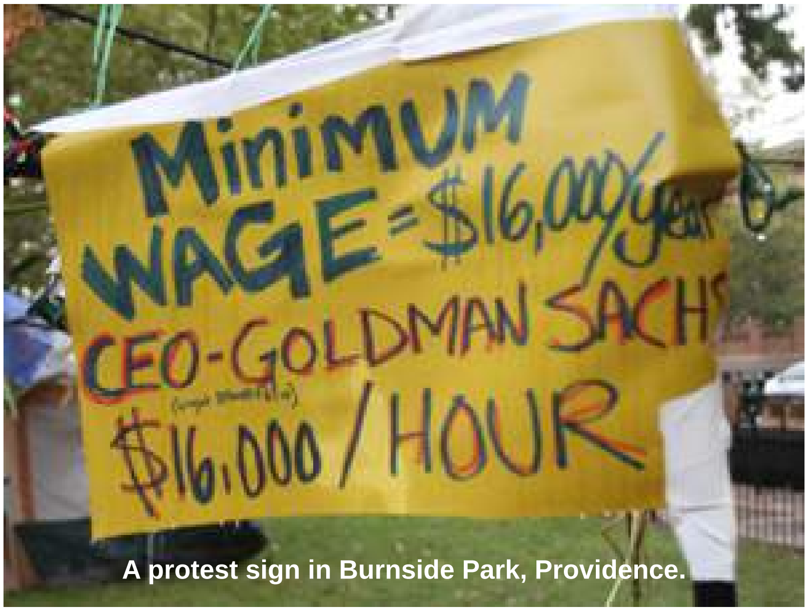
Average CEO pay remained relatively constant at around $1 million from the mid-1930s to the mid-1970s. However, at the onset of the shareholder revolution, influential theorists including Jensen and Meckling argued that CEOs would be better agents of stockholders if CEOs were paid like stockholders. Thus began the age of tying CEO pay to stock performance. Today, a CEO's base salary accounts for just 3–7 percent of his or her total pay package, and the rest is composed of a combination of performance pay or equity-based pay.

In 2012, average compensation for the 500 highest-paid CEOs was $30.3 million, of which an average of just $1.9 million or 6.3 percent consisted of salaries and bonuses. Realized gains from exercising stock options and from the vesting of stock awards accounted for by far the largest share of compensation—an average of $24.9 million. Restricted stock grants and stock option grants award shares to CEOs at distinct time periods, but both successfully reward CEOs with higher pay when stock prices rise. Another category of compensation, long-term based grants, ostensibly tie CEO compensation to the health of the corporation, of which a key measure is, of course, stock price (*Lazonick 2014*).

Corporate executives have been rewarded handsomely in exchange for serving shareholders. Average CEO pay increased 937 percent from 1978 to 2013, more than twice the increase in market capitalization.

Corporate executives have been rewarded handsomely in exchange for serving shareholders. Average CEO pay increased 937 percent from 1978 to 2013, more than twice the increase in market capitalization. In 2012, the average annual income of CEOs was 4.25

POWER: THE SHAREHOLDER REVOLUTION



A protest sign in Burnside Park, Providence.

times the average income of the top 0.1 percent of wage earners. Compared to average workers, of course, the divergence is even starker. The CEO-to-worker compensation ratio was 20:1 in 1965, but in 2013 the ratio stood at 295.9:1 (*Mishel and Davis 2015*).

This has changed CEO behavior. In a 2005 survey, almost half of managers said they'd reject a profitable project if it involved missing an earnings forecast from financial analysts. Even though this has serious consequences for the long-term health of the economy, it rationally makes sense for CEOs, since CEOs who just barely fail to exceed consensus profits will tend to have their total compensation drop by around 7 percent (*Terry 2015*).

The result has been a significant increase in the amount of firm income that is returned to shareholders each year in the form of buybacks and dividends. During the postwar period, buybacks and dividends averaged around 19 percent of profits. In 2014 it was 95 percent, climbing from 88 percent the year before. Immediately before the 2008 financial crisis, it was just a bit over 100 percent (Levine 2015). To state it more clearly, in recent years the corporate sector as a whole has returned as much capital to shareholders as it has made. This is a radical change in corporate governance that must form a core element of any discussion of financialization.

Consequences

The economic ideology behind the push for shareholder value assumes that all surplus should be returned to the capital owners because those owners will put each dollar of profit to its most productive use. Specifically, an extra dollar spent on internal investment or increased wages might not yield as high a return as if it were invested outside the firm. Thus all investment projects or worker benefits financed by a firm's earnings are subordinated to external opportunities that offer a larger return on investment. The logic is guided by the belief that shareholder primacy increases efficiency and thus economic growth. It is also undergirded by the assumption that the payouts to shareholders are the fair return for investor risk. However, these arguments have little basis in fact.

REDUCED INVESTMENT

J.W. Mason finds that from the 1950s through the 1970s, roughly 35–50 cents of every additional dollar of cash flow was invested in capital expenditure. About 50–75 cents of each borrowed dollar financed corporate investment during that same period. This relationship disappeared, and corporate investment overall declined, after 1980. Even at the height of the 1999 and 2007 booms, private investment as a share of GDP never reached pre-1980 peaks. Indeed, according to Mason's firm-level data, the relationship between cash flow and investment weakened post-1980. By 2000, high earnings were no longer a predictor of high levels of capital investment. Rather, firms increasingly used excess cash flow to reward shareholders through dividend payouts and share buyback programs. In fact, Mason finds a high level of correlation between borrowing and payouts. For every dollar a firm borrowed in 2007, approximately a third went to dividends or share buybacks. Mason concludes, "'firms borrow to fund investment' was a reasonable shorthand description of the financing decisions of large corporations in the 1950s, 1960s, or 1970s. But today, it would be more accurate to say, 'firms borrow to increase payouts to shareholders.'"

POWER: THE SHAREHOLDER REVOLUTION

Beyond the individual level, Mason also finds a strong relationship between funds and investment from the 1950s to the 1980s for the corporate sector as a whole. But by the late 2000s this relationship disappears, replaced by one of cash payouts. The large swings in credit flows to the corporate sector as a whole are not associated with any shifts in aggregate investment. This has serious consequences for monetary policy, as it means that aggregate investment might be less responsive to changes in debt financing (*Mason* 2015).

Using aggregate data, Engelbert Stockhammer finds that shareholder primacy was responsible for about a third of the reduction in capital accumulation in the U.S. from the late 1960s to the late 1980s. Leila Davis analyzed firm-level data to corroborate Stockhammer's results, finding payouts to shareholders were correlated with reduced investment at non-financial corporations in the post-1970 period. Her result is particularly strong among large non-financial corporations (*Stockhammer* 2002).

A new study with proprietary data compares public firms with similarly situated private firms. It shows that private firms not only invest less relative to public firms but also are less responsive to changes in investment opportunities. Specifically, private investment rates are nearly twice those of similarly situated public firms, at 6.8% versus 3.7% of assets per year. And private firms' investment decisions are four times more responsible to investment opportunities. This is a major difference with serious consequences (*Asker, Farre-Mensa, and Ljungqvist* 2014). This worry also shows up in surveys. Almost half of managers would reject a profitable profit if it meant missing an earnings forecast (*Terry* 2015).

BROADER ECONOMIC WORRIES

Beyond investment itself, there are broader worries about firms that are too dominated by the short-term interests of shareholders. First, these dynamics certainly increase inequality. The skyrocketing CEO pay of the past 30 years has been one of the key drivers of increased inequality among the top 1 percent (*Mishel, Schmitt, and Shierholz* 2014). Massive increases in buybacks and dividends have further strengthened capital income at the expense of labor income.

This also has an impact on innovation. Firms interested only in shareholder returns may be less inclined to take on the long-term, risky investment in innovation that is crucial to growth. Studies find a decline in innovation once firms go public (*Bernstein* 2012), a trend that can be exacerbated by the increased power of shareholders. Investment broadly, and innovation and research in particular, have significant spillover effects. These spillovers impact growth through technology and wages through employment and the development of skills. A weakening of this relationship can have serious long-term problems for our economy. A recent economic analysis put an estimate of the growth costs of this short-term focus at around 0.1 percent each year (*Terry* 2015).

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This can also have an effect on full employment. The delinking of corporate investment from financing has posed a serious challenge for monetary policy. The Federal Reserve's efforts to boost lending will have no effect on output or employment if they only encourage greater shareholder payouts rather than greater spending on real goods and services. Since the beginning of the Great Recession, macroeconomic policy has focused on restoring the health of the financial system in the hope that increased lending and easier credit will help boost the economy and bring about full employment. But there is good reason to believe that the real economy benefits less from easier credit than it once did (*Mason* 2015).

Solutions

As already stated, the shareholder revolution changed the intellectual, legal, institutional, and ideological landscape of corporate America. A counter-revolution will have to be just as bold. Such an agenda will require comprehensive and rigorous intellectual underpinnings along with legal and institutional changes that go beyond making sure that financial firms can fail without destroying the economy.

There are three broad goals for this agenda, on which forthcoming Roosevelt Institute work will elaborate. First, other stakeholders, particularly workers, need to be empowered relative to the rest of the firm. This includes broader pro-worker measures, such as a higher minimum wage and policies that generate full employment. Second, reforms need to be made to delink CEO pay from short-term price movements and restructure boards to make CEOs adhere to this. Reducing the performance pay loophole and addressing the safe harbor given to buybacks are two potential immediate focuses of reform. Adding additional representatives for workers or other stakeholders to boards is another promising avenue.

The shareholder revolution changed the intellectual, legal, institutional, and ideological landscape of corporate America. A counter-revolution will have to be just as bold.

The third aim will be to empower long-term shareholders relative to to short-term ones. Efforts to realign the firm with the long-term health of the company should be considered equally important as efforts to rein in CEO pay. And here everything from the tax code to regulations should play a central role. Both capital and financial transaction taxes can be used to encourage long-term holding periods for shareholders. The ability of investors to take into account long-term value when considering their legal obligations to clients should play a role as well. These regulatory changes are certainly worthy of pursuit and have the potential to mitigate the most damaging consequences of shareholder primacy; however, the most important change will be to reimagine the firm less as a vehicle for capital owners and instead as an organization that has space for innovation, risk-taking, and a stronger workforce.

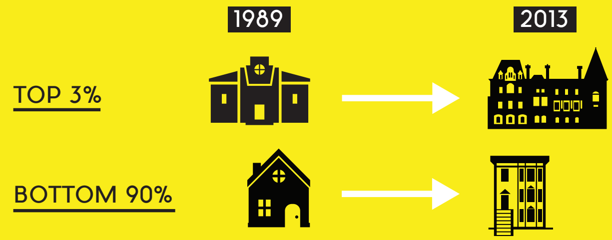
WEALTH: REDISTRIBUTION TO THE TOP

Along with the growth of the financial sector and the spread of its practices, all measures show that the prevalence of wealth in our economy has increased during the past 35 years. But wealth inequality has also dramatically increased during that period, following the same U-shaped curve that has been found for labor incomes. Capital has taken home an increasing share of national income, with labor taking home less. This increasing importance of wealth in our economy is an important element of financialization.

This section, building on previous work from the Roosevelt Institute, argues that the rules matter for inequality (*Stiglitz 2015*). The structure of the market through rules, laws, customs, and other governmental acts has significant repercussions for the economy. Though this argument is becoming more prevalent in relation to labor incomes, it is just as important when it comes to wealth. This section argues that public policy has helped generate wealth inequality in three distinct ways. First, public policy has helped polarize both market incomes and the creation of wealth. Second, public policy has helped solidify wealth for those who hold it, giving holders of wealth more power and protection than they would otherwise have. And third, public policy has limited the ability of others to challenge the concentration of wealth, guarding it from everything from bankruptcy to tax laws. Understanding the expansion of wealth in this way helps frame the inequality it creates as a distinctly political problem.

NUMEROUS STUDIES HAVE FOUND WEALTH INEQUALITY INCREASING.

THE TOP 0.1 PERCENT OF WEALTHY HOUSEHOLDS **TRIPLED THEIR SHARE OF THE WEALTH** DISTRIBUTION BETWEEN 1979 AND 2012, **GOING FROM 7 % TO 22%.**



THE SHARE OF ALL WEALTH HELD BY THE TOP 3% OF WEALTHY HOUSEHOLDS WENT FROM **44.8% IN 1989 TO 54.4% IN 2013** WHILE THE WEALTH OF THE BOTTOM 90% OF HOUSEHOLDS WENT FROM **33.2% IN 1989 TO 24.7% IN 2013.**

Numerous studies have found wealth inequality increasing, with some disagreement over where in the very top of the income distribution wealth inequality is increasing the most. Work by Emmanuel Saez and Gabriel Zucman finds that the top 0.1 percent of wealthy households tripled their share of the wealth distribution between 1979 and 2012, going from 7 percent to 22 percent. The Federal Reserve Board finds in its Survey of Consumer Finance that the share of all wealth held by the top 3 percent of wealthy households went from 44.8 percent in 1989 to 54.4 percent in 2013, while the wealth of the bottom 90 percent of households went from 33.2 percent in 1989 to 24.7 percent in 2013 (*Saez and Zucman 2014*).

Polarization of Incomes

Polarized wealth will naturally result from polarized incomes, and income inequality has skyrocketed in the past 30 years. According to the Congressional Budget Office, the percentage of GDP taken home by the top 1 percent nearly doubled between 1979 and 2007. Meanwhile, median incomes have barely budged, much less kept up with the productivity gains of the U.S.

economy. Median incomes collapsed in 2007 and continued to decline even after the Great Recession technically ended in 2009.

Economists and other researchers have debated what has been causing this increase in income inequality since the late 1970s. Most researchers argue that income inequality is the result of some combination of technology, skills, globalization, sociology, and public policy. Experts in the 2000s tended to argue that changing technology and skills were the cause of income inequality, yet starting in the 2010s they began to identify public policy as a key driver of income inequality (*Stiglitz 2015*).

Mechanically, this income inequality will lead to wealth inequality, but wealth inequality itself is also a product of policy changes. There is less research on the causes and consequences of wealth inequality, though this is recently changing. Thomas Piketty's Capital in the 21st Century argues that there are laws that generate increasing wealth inequality as a result of the difference between the growth rate of the economy and return on wealth, creating a dynamic in which wealth naturally tends to concentrate. Capital will tend to increase faster than economic growth, meaning that the wealth of the past will "suffocate" the incomes of the future. Ta-Nehisi Coates's Atlantic essay "The Case for Reparations" details the history of racist policies that kept a large part of the populace from building wealth, particularly in housing, and other writers have expanded on the predatory nature of mortgages during the housing bubble.

There are laws that generate increasing wealth inequality as a result of the difference between the growth rate of the economy and return on wealth, creating a dynamic in which wealth naturally tends to concentrate.

Increasing the Prevalence of Wealth Claims

As Piketty argues, capital "is always in part a social and political construct: it reflects each society's notion of property and depends on the many policies and institutions that regulate relations among different social groups, and especially between those who own capital and those who do not" (*Piketty and Goldhammer 2014*). Since the 1980s, both the notions and institutions have tilted in favor of wealth holders relative to other economic stakeholders. Some of this was by design and some of it was by accident, but all of it directly affects the distribution of wealth ownership.

There are many examples available of the rules of the economy increasingly tilting toward wealth holders compared to other economic stakeholders, including changes in intellectual property law, money in politics, and financial deregulation.

INTELLECTUAL PROPERTY LAW

Contemporary patent law is rooted in Congress's constitutional power to grant authors and inventors temporary exclusive ownership over their products. The framers hoped this provision would incentivize work in science and the arts, but today our societal prerogative to protect intellectual property has grown to encompass patents that protect monopolies and reduce innovation, resulting in enormous public costs.

The prescription drug industry is perhaps the best example of patents gone wrong. In 2011 Americans spent nearly $300 billion on prescription drugs that cost only $30 billion to produce. That $270 billion in profit went directly to large drug companies at the expense of America's workers, the elderly, and the employers that help pay their medical insurance (*Baker 2011*).

There is a need to reward institutions for their research, but patents are only the method we have arbitrarily elected to use for this purpose; other, less societally costly solutions, like a prize-based incentive, could be even more effective at spurring research and innovation, and could do so without the anti-competitive side effects of our current system.

Aside from the direct monetary costs to society, U.S. patent policies hurt growth by preventing competition and driving down innovation. Strong patent protections, which largely arise from the lobbying of special interests, prevent new industry entrants from building on existing ideas. In doing so, patent protections end up slowing innovation rather than encouraging it. Less innovation means fewer new businesses as well as fewer new and useful products and services for American consumers, so the losses are distributed to society while the gains are privatized (*Tabarrok* 2011).

INCREASED LOBBYING

The influence of money on politics is not news to most Americans, yet it persists as a major factor obstructing democracy in Washington. According to the Campaign Finance Institute, congressional candidates in 2010 spent $1.8 billion, with corporate PACs alone contributing $153.7 million. Lobbies spend these enormous sums in order to guarantee that lawmakers keep their best interests in mind when drafting and voting on legislation. Rather than represent their constituents' best interests, politicians end up working to meet the needs of their corporate benefactors.

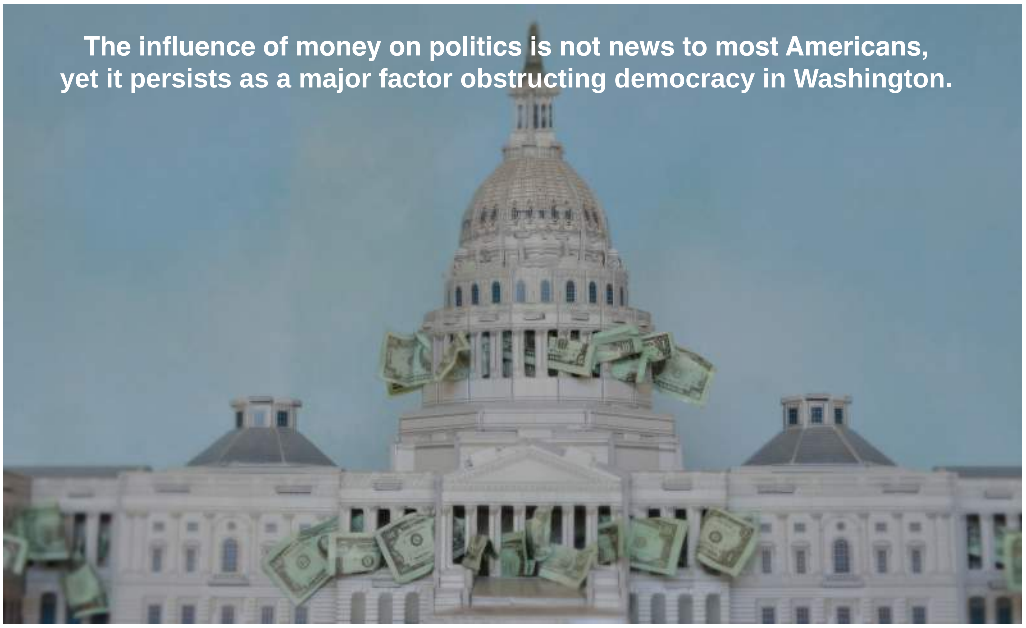
Harvard professor Lawrence Lessig (2011) highlights the bipartisan nature of the problem: both Republicans and Democrats are targeted by special interests. In 2009, lobbyists spent an average of $6.5 million per member of Congress (*Shaw* 2012). The investment theory of party competition, pioneered by Thomas Ferguson (1995), suggests that contributions by various interest groups, from corporations to labor organizations, drive and constrain the political agendas of both parties. In doing so, they drive a wedge between voters and their representatives.

FINANCIAL DEREGULATION

For several decades prior to the Great Recession, financial regulations were changed to be far more favorable to the financial sector. The passage of several bills from the early 1970s through the 1990s allowed for the massive consolidation of the financial sector. The 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act removed limits on inter- and intra-state branching requirements. The removal of Glass-Steagall through a series of acts culminating in the Gramm-Leach-Bliley Act of 1999 also allowed for a concentration across business lines.

At the same time, there was movement away from consumer protection in financial regulations. One of the early victories for the financial industry was the 1978 Supreme Court decision in Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp. The Court interpreted the word "located" in the National Bank Act of 1863 as meaning the location of the business and not the location of the customer. As a result, there was an immediate race to the bottom among the states to create bank-friendly usury laws, consumer protections, and terms and interest rates with which consumer products—primarily credit cards—could be issued.

Federal regulators also went to great lengths to preempt state-level consumer financial protection laws. For instance, in 2003, the Office of the Comptroller of the Currency (OCC) overruled the Georgia Fair Lending Act, a bill designed to help



WEALTH: REDISTRIBUTION TO THE TOP

stop subprime lending. The OCC did this on the assumption that the bill was "unnecessary" because it would put "impediments in the way of those who provide access to legitimate subprime credit."

Financial deregulation also included deference to new financial instruments. An example of this deference was the treatment of U.S. Commodity Futures Trading Commission Chair Brooksley Born in 1998 when she circulated a concept release paper investigating a then-new derivative known as a swap. She came under immediate pressure from regulators including the Federal Reserve's Alan Greenspan and U.S. Secretary of the Treasury Robert Rubin.

Regulators have also deferred to the financial sector to regulate itself. As Alan Greenspan said in 1998, the "use of internal credit risk models" could serve as a "possible substitute for, or complement to, the current structure of ratio-based capital regulations" called for by regulators. He also argued that "[s]upervision has become increasingly less invasive and increasingly more systems- and policy-oriented. These changes have been induced by evolving technology, increased complexity...not to mention constructive criticism from the banking community."

Prioritizing Wealth Claims

More important than simply creating and expanding wealth claims, policy has prioritized wealth claims over competing claims on the economy, from labor to debtors to the public. This isn't just about increasing the power of wealth; it's about rewriting the rules of the economy to decrease the power of everyone else.

FULL EMPLOYMENT

Full employment is the macroeconomic goal of keeping the economy at peak output, where resources are fully utilized. It is guided by government action through both the fiscal budget and monetary policy, and, during the past 30 years, it has become far less of a priority. Between 1945 and 1980, unemployment averaged 5.2 percent; from 1980 to 2008, it averaged 6.5 percent. Even worse, from January 2008 to February 2015, unemployment averaged 7.8 percent.

Responsibility for ensuring maximum employment falls to the Federal Reserve, but the central bank's results have also significantly deteriorated. Between 1949 and 1980, unemployment was below the Fed's full-employment benchmark—an estimated rate of "natural" unemployment—in 68 percent of quarters. From 1980 to 2012, unemployment was lower than that benchmark just 30 percent of the time.

Periods of full employment are necessary for significant and sustained wage growth. Researchers have found that the unemployment rate falling 10 percent is associated with a 10 percent increase in the 20th percentile wage (*Baker and Bernstein* 2013).

Periods of full employment are necessary for significant and sustained wage growth. Researchers have found that the unemployment rate falling 10 percent is associated with a 10 percent increase in the 20th percentile wage *(Baker and Bernstein 2013).*

HIGH INTEREST RATES

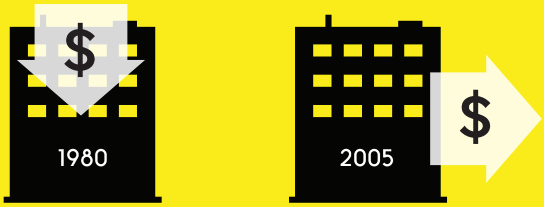
Another consequence of monetary policy since the 1980s has been the persistence of high real interest rates. This is the result of monetary policy starting with Paul Volcker's Federal Reserve, and became extra relevant when monetary policy hit a "zero lower bound" during the Great Recession. Indeed, part of the troubles facing the Federal Reserve during and after the Great Recession is that real interest rates remain too high.

This has consequences that include higher profits for the financial sector. As Gerald Epstein (2005) has found, "profits earned by firms engaged primarily in financial intermediation plus interest income realized by all non-financial non-government resident units, i.e. the rest of the private economy" have increased alongside real interest rates. These finance activities

FINANCE USED TO BE ABOUT GETTING MONEY INTO FIRMS. NOW IT IS ABOUT GETTING MONEY OUT OF THEM.

A FIRM BORROWING $1 WOULD INVEST 76 CENTS.

A FIRM BORROWING $1 INVESTS ONLY 6 CENTS.



IN 2014, 95 PERCENT OF PROFITS WERE RETURNED TO SHAREHOLDERS ACROSS THE CORPORATE SECTOR.

and the way they have spread to non-financial firms have reshaped the overall economy.

Another consequence of high interest rates is that it has become harder for middle-class Americans to pay down debt. If borrower costs faced by consumers increase while inflation and wage growth decrease, the real burden of consumer debt mechanically increases. This can account for much of the growth of consumer debt before the housing bubble, as recent research by J.W. Mason and Arjun Jayadev (2012) has found. Many on the left have attributed this rise to weak wage growth and questionable practices by the financial sector, while many on the right blame it on the personal moral failings of individual households. But in Mason and Jayadev's model, "the 1980s, in particular, were a kind of slow-motion debt-deflation, or debt-disinflation; the entire growth in debt relative to earlier period…is due to the slower growth in nominal income as a result of falling inflation."

BANKRUPTCY LAW

Bankruptcy law is one of the crucial mechanisms for balancing the power of debtors and creditors, and one of the biggest recent changes in the legal restrictions surrounding wealth was the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). This law revamped how bankruptcy was structured by making it more difficult to file for bankruptcy, removing bankruptcy protections on student debt for private student loans, and protecting the financial industry. All of these changes have consequences for wealth distribution.

A stated goal of BAPCPA was to make it harder for consumers to file for bankruptcy. One of the crucial ways it did this was by extending the time it takes to file for bankruptcy. Many of the features of the bill, from credit counseling to filing fees, are designed to expand the period of financial distress before a bankruptcy proceeding can take place. This increases both the fees and the size of the debt under question, leading many to believe it functions like a "sweat box" for debtors (*Mann* 2006).

BAPCPA also removed bankruptcy protections on student debt for private student loans. This was the culmination of several decades of reduced protections on student loans, starting in the late 1970s. First student loans weren't dischargeable in bankruptcy during their first five years. Then, in 1996, Social Security payments became eligible to be garnished to pay student loans. In 1998, the statute of limitations was removed so that public student loans were never dischargeable. BAPCPA extended all this to private loans. At the time, the private lender Sallie Mae pushed for this reform above all others. A study by Mark Kantrowitz found that this change did little to increase the availability of private student loans to students with poor credit, which is precisely what it was supposed to do (*Konczal* 2011).

BAPCPA had significant benefits for the financial industry. It cemented the protection of derivatives in bankruptcy. It also allowed derivative holders to terminate their contracts, unlike other parties to a bankruptcy, so they have the option to cut and run. Alternatively, derivative holders have the option to take their collateral, unlike secured creditors. The law provides no recourse for, say, preferential or fraudulent behavior by derivative holders.

These protections for derivative holders are likely to trigger bank runs. Derivative holders have the option of demanding their collateral when they get nervous, though they are subject to mechanisms such as an "automatic stay" designed to impose a cooling-off period. Much of the difficulty of financial reform under the Dodd-Frank Act has been in trying to create a system that will allow a major financial firm to fail

WEALTH: REDISTRIBUTION TO THE TOP

while keeping these derivative protections in place. Major regulators have called for the reexamination of this strategy, but there has been no action on this front (*Konczal 2010*).

BAPCPA has made recovery from the Great Recession more difficult. Many leading theories attribute the recession to the collapsed housing market as a source of decreased demand and falling investment, with defaults and housing foreclosures creating a downward spiral of housing prices. Bankruptcy reform was designed to make it harder to liquidate unsecured debt to cover secured debt, such as housing with an attached mortgage. According to research from the New York Federal Reserve, "the subprime foreclosure rate after BAR rose 11 percent relative to average before the reform; given the number of subprime mortgages nationwide, that translates into 29,000 additional subprime foreclosures per quarter nationwide" (*Morgan, Iverson, and Botsch 2012*).

TAXES

Much of the difficulty of financial reform under the Dodd-Frank Act has been in trying to create a system that will allow a major financial firm to fail while keeping these derivative protections in place.

During the 2000s, capital taxation was reduced rapidly. The operative theory was that this would increase investment, as it would reduce the cost of capital to corporations. However, as noted above, the function of today's stock market is more about getting money out of firms than it is about getting money into them. Indeed, firms usually use the stock market to release funds and use internal cash flow and borrowing to raise funds.

The dividend tax cut of 2003, in particular, was a major change in tax policy. Yet empirical research finds that corporations that received a dividend tax cut spent no more on investment in the aftermath than similar firms that did not receive the tax cut, a finding consistent across a large battery of control groups. The only difference was an increase in the amount of dividends paid to shareholders. Given the concentration of wealth in the United States, this tax cut mechanically increased wealth inequality (*Yagan 2013*).

Solutions

Though wealth inequality has increased, there's a sense that its solutions should mirror the solutions for income inequality. Yet many efforts to make the wealth distribution more equitable have gone hand-in-hand with efforts to privatize and shift risks onto individuals, as seen in George W. Bush's "Ownership Society" agenda.

This points at the first important response to wealth inequality: Keep the public safety net public. Privatizing Social Security would increase "wealth," as there would be claims individuals could point to, but it would lead to less security. Efforts to further accelerate a portfolio society, as discussed in the next section, should be resisted.

The second response is to empower other stakeholders relative to wealth holders. This especially includes workers through measures such as full employment at the economy level and worker say at the firm level. But it also includes debtors relative to creditors, and as discussed in the previous section, stakeholders relative to shareholders.

And the third is to make sure wealth continues to serve a broader public purpose. This includes revisiting intellectual property law and the way it can protect incumbents relative to other firms. It also includes taxes on capital and inheritances. These taxes aren't just to raise revenue; capital taxes help keep money inside the firm for investment, and inheritance taxes can direct private dynasties into public charities that enrich everyone.

WEALTH: REDISTRIBUTION TO THE TOP

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Ultimately, financialization is about how we see society. Business professor Gerald Davis defines a portfolio society as one in which "entire categories of social life have been securitized, turned into a kind of capital." This capital fiction emphasizes individual rather than collective responsibility, as we see in the modern U.S. When it comes to security in old age, people no longer depend on their companies for pensions, or on the state for Social Security, but rather on their own 401(k)s. Higher education is no longer a state responsibility, or provided collectively, but instead a private, individual investment in "human capital" that one makes with debt contracts, like a miniature corporation. In this scenario, the state is less a partner in developing the conditions for a rich society than it is a portfolio of objects and functions that can be sliced off and privatized.

Viewing oneself as an entrepreneurial business is an interesting sociological phenomenon, but it also has harmful consequences for public policy and economics because it coincides with three important trends that will exacerbate inequality: the administration of public policy through tax expenditures, the privatization of public institutions and functions, and the individualization of risk.

The Submerged State

The first issue is that the portfolio society relies on tax expenditures, or government spending through the tax code, to achieve public ends, developing what political scientist Suzanne Mettler calls the "submerged state." A submerged state is one that uses "public policies designed in a manner that channels resources to citizens indirectly, through subsidies for private activities, rather than directly through payments or services from government." The size of the submerged state has almost doubled in the past 40 years, going from 4.2 percent of GDP in 1972 to 7.4 percent of GDP in 2008 (*Mettler 2011*).

There are several problems with the submerged state. The first is that it amplifies inequality. Tax expenditures

THERE ARE SEVERAL PROBLEMS WITH THE SUBMERGED STATE. IT AMPLIFIES INEQUALITY.

are thought to be regressive, benefiting those with more resources. The general argument for why this is so is that tax expenditures are closely linked with employment compensation or spending, so those who have jobs and get paid more or spend more also benefit more. Being able to pay less in taxes disproportionately benefits those better off and those with the resources and ability to take advantage of often complicated tax planning. A privatized welfare state administered through these coupon-like mechanisms, as opposed to direct public spending, involves less compulsory risk-pooling and more individualized risk-bearing, which tends to benefit those who are better off (Hacker 2002).

The stakes of this are huge. Consider the following three major tax expenditures: health insurance, mortgage deductions, and the preferential tax rate on capital gains and dividends. Health insurance provided through an employer is excluded from taxable income. According to estimates by the Congressional Budget Office (CBO), in 2013, this tax break was worth $248 billion, or about 1.5 percent of GDP. Interest paid on a mortgage can be deducted from taxes, which was worth around $77 billion, or 0.5 percent of GDP, in 2013. Capital gains and dividends are taxed at a lower rate than regular income; that tax expenditure was worth $161 billion in 2013, or 1 percent of GDP.

Privatization replaces the discussion of what the government should do with the allocation of what it does.

Next, note how regressive these policies are. The top 40 percent of households ranked by income take home 60 percent of the health insurance expenditure, and that is the least regressive of the three. The top 20 percent of households take home 73 percent of the mortgage deduction; they also receive 93 percent of the preferential rate for capital income, with 68 percent going to the top 1 percent alone (CBO 2013).

Even the tax expenditure designed to help working families, the earned-income tax credit (EITC), benefits non-workers. According to the CBO, 51 percent of the EITC goes to benefit the poorest 20 percent of households. However, by drawing more workers into labor markets, the EITC can drive down wages to the benefit of employers. According to some estimates, a quarter of the EITC may be captured by employers (Rothstein 2010). Meanwhile, because the EITC is administered through the tax code, it is subject to the confusion of intended recipients and abuse by people who should not be recipients. The Internal Revenue Service estimated that 24 percent of all EITC payments from 2013 were made improperly, which demonstrates how difficult it is for people without means to take advantage of tax expenditures even when they are meant to benefit from them (*Treasury 2014*).

Privatization

Another important element of portfolio society is that it focuses on the privatization of public institutions and functions. Privatization has many different meanings in the political context; sometimes it means the introduction of profit motive and market competition while maintaining government ownership, while at other times it means simply shifting ownership to private hands, even if normal market competition might be missing in the industry (*Starr 1988*).

What might be problematic about the privatization of government services? The first concern is that it has the potential to introduce significant opportunities for abuse into government functions. Private-sector providers of services can use the opportunity to abuse the process of allocating government services, wasting taxpayer resources.

This leads to less government innovation and an inability to meet citizen needs. Parking meter privatization in Chicago, for instance, became a major obstacle to the creation of express bus lanes as well as bike lanes. Before the meters were privatized, the city itself could have approved changes to its roads and decided how to make up the lost revenues, but now a

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for-profit company has to give approval and can use its bargaining power—and lack of incentive to serve the public interest—to extract more rents.

Government privatization also allows private individuals and ultimately the state itself to circumvent state accountability and transparency measures. A large number of government transparency laws, from the Freedom of Information Act to the Administrative Procedure Act, do not apply when government actions are privatized. Privatization discards the liberal conception of what democracy itself is good for: checking private and government power and promoting accountability and responsiveness (*Freeman and Minow* 2009).

Privatization replaces the discussion of what the government should do with the allocation of what it does. Though some claim that privatization creates innovation, it instead largely keeps the scope of government services consistent while seeking efficiency gains; the real gains come from minimizing costs, not from innovation (*Dolovich* 2007).

Another major problem with the privatization of government services is that it replaces funding streams drawn from general revenue with individual user fees. Fees, charges, and miscellaneous general revenues now account for a third of all state and local government own-funding, and that proportion is increasing (Rampell 2014).

Individualized Risk

Put these together, and we get a new system of social insurance in which individuals are expected to carry their own risks. Consider both student debt and 401(k) vehicles for retirement security.

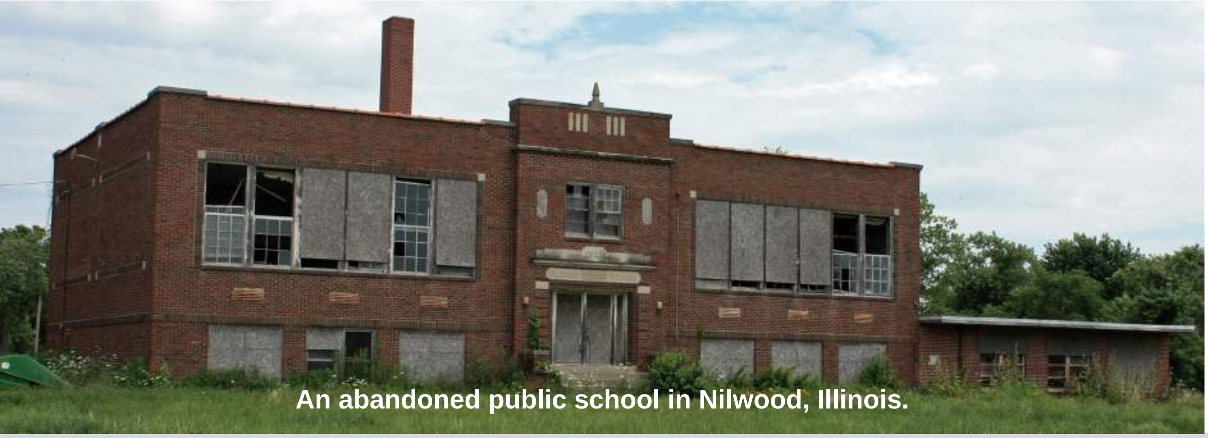
STUDENT DEBT

Student debt, once a minor item in personal finance, has exploded over the past two decades. Between 2004 and 2012, total student debt tripled from $364 billion to $966 billion. Two-thirds of that debt is owed by borrowers under 40. This increase can be described using two different 70 percent figures: Between 2004 and 2012, the number of borrowers increased 70 percent, from 23 million to 39 million, yet the average debt per borrower also increased 70 percent, from $15,000 to $25,000 (*Brown* 2015).

There are many reasons for the rise of student debt. An important one is the transfer of costs from the public to individual students, which has resulted from state disinvestment in public higher education (Hiltonsmith and Draut 2014). But another major shift has been the notion of education as a form of "human capital." Popularized by Gary Becker and other economists, the theory of human capital seeks to view education, among many other choices, as an investment that individuals make in themselves. Viewing higher education this way, student debt simply becomes a minor accounting problem, with a debt balanced by an asset in higher education.

This diverges from a more historical view of higher education, one in which it was the role of the community to make sure those who wanted to seek an education could do so. During the mid-century period, plans such as the California Master Plan, which created the tripartite system of community colleges, state colleges, and flagships, affirmed the goal of the state to provide an education for all.

Disinvestment in public education has preceded the rapid expansion of for-profit schools. The for-profit education industry grew from roughly 2 percent of institutions


An abandoned public school in Nilwood, Illinois.

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and students in 2000 to 10 percent by 2010. The institutions themselves have also changed from dispensers of mail certificates to companies with a shareholder mission to extract maximum subsidies from the state (Bady and Konczal 2012).

According to several measurements, student debt as a percentage of income hasn't changed much in the past decade, but the number of years it takes students to pay off that debt has. It now takes borrowers twice as long to pay off student debt as it did 10 years ago, and that interval will continue to grow. Some argue that the length of student debt repayment should mirror the entire length of a working career because that is how corporate finance theory argues projects should be financed. But people aren't corporations. There is evidence that student debt leads to less entrepreneurship, less work in volunteer and non-profit occupations, and delays in both marriage and wealth-building. These consequences will spread throughout the economy as a whole (*Konczal* 2014).

401(K)S

In their current form, 401(k)s came into existence in 1981, when the Reagan Administration ruled to allow workers to set aside their earnings for retirement, tax-free. Roughly 12 years later, stock markets began a five-year spike that nearly tripled the Dow Jones Industrial Average and magnified the perceived value of a 401(k) in the minds of American workers. Since then, 401(k) s have become the retirement plan of choice for employers, eclipsing traditional pensions by the late '90s, and lawmakers have chipped away at 401(k) and Individual Retirement Arrangement (IRA) regulations, making both types of account more flexible and robust, to the great benefit of wealthy Americans.

While it is true that the value of America's 401(k) s has skyrocketed, it is equally clear that this shift has come at an enormous cost to average Americans. As 401(k)s rose, defined-benefits plans largely disappeared from many sectors and Social Security benefits were reduced. By the late '90s, the median American family had 11 percent less retirement wealth than it did in 1983. Simultaneously, the low end of the retirement wealth spectrum dropped off, increasing the number of families in serious retirement peril.

Although the creation of the modern 401(k) happened in a somewhat piecemeal and incidental fashion, its evolution has been in no way accidental. Between the late '70s and late '80s, American corporations cut their retirement spending in half by moving from pensions to 401(k)s.

A big reason for these savings is that 401(k)s shift the burden of investment and management to workers, who may be too busy or inexperienced to handle these tasks properly; about one-third don't contribute at all, to say nothing of those who invest or manage their accounts poorly. As such, the 401(k) benefits go overwhelmingly to wealthier and more financially literate workers, creating a highly regressive tax break (*Hacker* 2008).

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Solutions

This problem is one of the more difficult to tackle, as it involves both policy changes and a conceptual change of what the state does. However, there are several ways to begin to combat it.

The first is to push back against the "submerged state" approach to providing government services. This involves capping tax expenditures and deductions to help push back against their regressive character. It also involves expanding public programs that are successful, such as Social Security, and converting private submerged programs that are unsuccessful, like 401(k)s, into public ones, like a public IRA.

The second is to rebalance the relationship between the federal government and the states. Take higher education: Proposals to split the costs between the federal government and states while explicitly making colleges affordable have a number of benefits. The Great Recession showed how weak individual states are when it comes to providing necessary services and social insurance, but the federal government's borrowing costs remained consistently low.

The third is embracing the concept of public options. Public options are capable of ensuring cost control, broad access, a floor of quality, and a measure for private options to compete against. This relates to everything from health care, where a public option could be added to the exchanges, to higher education, where public universities and colleges supplement private efforts to provide mass education.

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CONCLUSION

Financialization is a story about the growth of the size and scale of finance, finance's increasing power over our economy, the empowerment of wealth relative to other interests, and the increasing view of society as a bundle of financial assets to be traded and sold. As we've demonstrated, each of these has accelerated inequality and led to a more precarious economy for everyday people.

The growth of finance and its role in administering our collective savings has come with excessive fees and a dangerous shadow banking sector. This has channeled resources and talent away from more productive enterprises and toward destructive bubbles, including a housing bubble that devastated the economy and continues to plague many states and neighborhoods. The increasing influence of finance on the governance of our corporations has led to an explosion of resources leaving firms and a decline in investment, threatening everything from wages to the spillover effects of innovation.

Outside the shareholder revolution, the rules of the economy have been rewritten to benefit wealth more broadly. This comes at the expense of other participants in the economy, with detrimental effects for debtors, workers, and other economic stakeholders. And the world that comes with the portfolio society is one that is increasingly individualized and risky and provides less security for most Americans.

With rough guidelines provided here, the rest of this project will provide a forward-looking roadmap out of this situation. The solutions are both possible and necessary to build an economy that works for all.

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