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Financialization of The United States Economy and the Effect on Small Firms and the Consumer

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Financialization of The United States Economy and
the Effect on Small Firms and the Consumer

A Senior Project Submitted to

The Division of Social Studies

Of

Bard College

by

Bradford Johnson

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Bradford Johnson

Abstract:

The recent trend of financialization affects small firms and the consumer. It follows the rise of the financial sector and what was in place for the rapid growth of it. The rapid growth of it also creates instability in the economy and the instability is studied to determine where it arose and how it can be reformed. The reform of the financial sector is aimed at suppressing corporate interests to satisfy that of the consumer and protect the small firm. The protection of consumer interest is rationalized in the need for small firms to satisfy consumer demand most efficiently.

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Chapter 1: History of Financialization

1.1: Emergence of a Financial Sector

The history of financialization summarizes the growing financial sector and accumulation of financial assets after Industrialization and up to the response to the most recent crisis. The accumulation of financial assets has extended beyond the financial sector, but extended into other areas of the real economy. The financial sector was created for investors to secure investments to promote industry. As the financial sector was able to be profitable through the accumulation of financial assets, the production of real goods and services declined. Speculative tendencies began to emerge in the later half of the 19th century that helped propel the financial sector to its current short-term profit maximization. Short-term profits were generated through the speculation of financial assets. The financial assets that were accumulated emerged from across the economy and this became known as the financialization of the economy.



Source: The Evolution of the US Financial Industry from 1860 to 2007: Theory and Evidence. NBER.¹

1.2: Emergence of Financialization

The financialization of the economy refers to the direct accumulation of financial assets across the United States economy. The financial assets are accumulated in order to short them and make a profit. Financialization is rooted in altering investment in order to maintain profits without increasing capital investment. Decreased regulation allowed financial institutions to engage in speculative practices lowering capital investment. The decline in capital investment shifted the labor market because of decreased lending for the creation of firms. Industries are no longer surviving on capital investment because financialization has shifted market power and market concentration to support financial assets. The accumulation of financial assets has caused inequality in the United States to grow significantly and equate to the inequality in developing countries.² The growing financial sector pushed the limits of inequality and created financialization because of the accumulation of financial assets outside of financial corporations.

1.3: Creation of Financial Intermediation

Financialization emerged because of the need for financial intermediation across varying industries. Epstein interpreted financialization as the increased emergence of financial markets, actors, establishments, and purposes.³ The introduction of financial

¹ Kedrosky, Paul, and Daniel Stangler. 5.

² Lin, Ken-Hou, and Donald Tomaskovic-Devey. "Financialization and US Income Inequality, 1970-2008." *SSRN Electronic Journal* 118, no. 5 (2013): 1285-313. doi:10.2139/ssrn.1954129. 1285.

³ Epstein, G. 2001. "Financialization, Rentier Interests, and Central Bank Policy,"

markets throughout the country allowed the sector to grow quicker. The financial sector was obtains market power from non-financial corporations because of its ability to globalize.⁴ The financialization of the United States economy is not only restricted to the United States financial institutions, but also includes financial assets accumulated around the world. The overall global push towards finance has allowed the United States financial sector to become one of the largest industries in the country. Following the Great Depression there was a renewed need for financial intermediation because of the emphasis on avoiding another depression. Financial intermediation and regulation were viewed as a way to prevent another crash.

1.4: Financial Intermediation and Regulation

The continued rise of the financial sector since the end of the Great Depression supports the increased regulation to protect the financial sector. Although the financial sector has not collapsed since the Great Depression, the economy has suffered while the financial sector has grown to historic levels. Financial intermediation is needed, but the regulation that has allowed the financial sector to engage in speculative and risk oriented behavior should be changed. Some of the speculative tendencies used within the financial sector include the purchase of CDO's as well as the emphasis on stock buybacks and dividends. The speculative nature of financial instruments are unable to promote real investment in the real economy.

manuscript, Department of Economics, University of Massachusetts, Amherst, MA, December.

⁴ Davis, Gerald Jerry F., and Suntae Kim. "Financialization of the US Economy." *Emerging Trends in the Social and Behavioral Sciences*, 2015, 1-30. doi:10.1002/9781118900772.etrds0132. 2.

1.5: Flaws of Financial Intermediation

Financial intermediation is always needed, but wavering demand over time did not correlate with the output of the financial sector so the sector engaged in speculative tendencies to raise profits. Consumer debt before the Great Depression, established the need for financial intermediation to prevent economic failure. In the decades following the Great Depression the financial sector returned to its pre-depression size in a third of a time it previously took to grow⁵ indicating the need for financial intermediation. The immediate need for financial intermediation caused the financial sector to grow too rapidly and create an unstable equilibrium. The unstable equilibrium refers to the continued growth of the financial sector. The rapid growth of the sector is unstable and puts the entire economy at risk. Although an inherent risk exists, regulation has favored corporations and accumulation of financial assets.

The regulation and policies created were necessary to promote financial intermediation, but their clear favoritism towards financial institutions and those who chose to support financial institutions placed a greater burden on consumers and rising debt. The management and creation of debt is a critical factor in financial intermediation. It has contributed significantly to economic crises because debt was reduced after the Great Depression, but rose in the 1980's representing the

⁵ Kedrosky, Paul, and Daniel Stangler. "Financialization and Its Entrepreneurial Consequences." SSRN Electronic Journal, March 2011, 1-15. doi:10.2139/ssrn.1798605. 3.

financialization of the economy. The resurgence of credit created a commodities market where financial institutions traded debt in the form of financial assets. The higher level of debt became a source of profit for financial institutions, but it constrained consumers and the firm. Regulation has not improved financial intermediation in order to protect non-financial sectors.

1.6: Financialization and Non-financial Sectors

The lack of protection for non financial sectors has shifted investment away from firms without financial assets. The accumulation of financial assets has become a way for firms to protect themselves and ensure profitability. Financialization has weakened Non-financial corporations because the higher levels of debt are an indicator of financial restriction quelling investment.⁶ This restriction has forced non financial firms to engage in financial activities that did not correlate with the business model within industries. Financial intermediation is crowding out real investment for specifically non financial firms because the business cycle has been altered. This is also seen in the rapid shift of non-financial firms not making a profit, but only survive the increased threat of financial institutions.⁷ Consumer debt has increased to over 100% of GDP⁸, contributing to the inability to profit from sales alone. The current level of consumer debt will inhibit the

⁶ Orhangazi, Özgür, 2008. Financialisation and capital accumulation in the nonfinancial corporate sector: A theoretical and empirical investigation on the US economy: 1973–2003. *Cambridge Journal of Economics* 32, 863–886. 867.

⁷ Arnum, Bradford M. Van, and Michele I. Naples. "Financialization and Income Inequality in the United States, 1967-2010." *American Journal of Economics and Sociology* 72, no. 5 (2013): 1158-182. doi:10.1111/ajes.12036. 1165.

⁸ Philippon, Thomas. 238.

survival of small firms because there are no longer enough consumers to support non-financial firms.

1.7: Accumulation of Financial Assets

The accumulation of financial assets and instruments by firms outside of the financial sector indicate that financialization is affecting the whole economy. The economic trend towards financial protection is seen in the accumulation of diverse financial assets. The accumulation of diverse and risky assets that has occurred because of regulation supporting the financial sector, has forced the rest of the economy to falter and suffer the consequences of the financial sector's recovery.⁹ This has been a primary problem in financialization because it only protects very few people, as opposed to the whole economy.

The creation of profits through financial channels have only created greater constraints on the rest of the economy and allowed the financial sector to become greater risk takers, as they benefit from high risk high reward.¹⁰ The risk that the financial sector takes has a negative result on the entire economy through job loss, firm deaths, and lack of real investment. The risk and resulting consequences of unsuccessful financial intermediation creates inequality because the entire economy takes the burden of a limited group of people. The market power of the financial sector has allowed it to emerge into others sectors of the economy.

⁹Nersisyan, Yeva, and L. Randall Wray. "The Global Financial Crisis and the Shift to Shadow Banking." SSRN Electronic Journal, February 2010, 1-30. doi:10.2139/ssrn.1559383. 4.

¹⁰ Lin, Ken-Hou, and Donald Tomaskovic-Devey. 1313.

1.8: Shift in the Financial Sector

The expansion of the financial sector is partially due to the unavoidable need for financial intermediation, but also includes the willingness of firms to accept this as the future of business. The growth and maintained profits of businesses have caused the economy to appear more stable coexisting with the financialization of the economy. The economic resurgence in the 1980's was able to promote investment and trigger economic activity, but these were mainly contributions to the financial sector.¹¹

The investments in the financial sector included the process of non financial firms investing in their own financial instruments compromising their profits. Although it was not always the case, top producers decreased production and created financial arms as their primary source of profit.¹² This decline in production and shift in firm behavior contributed to job loss in the whole economy. Because firms can survive and remain profitable, the true impact on the economy is ignored.

1.9: Policy Implications of Financialization

The policy enacted in response to financialization has been inefficient in regulating the financial market. The shift has occurred because over time policy has weakened the regulation of the financial sector creating instability. The varying strengths of the financial sector within the United States economy represent varying levels of financial intermediation in response to the needs of an inflated economy. The

¹¹ Arnum, Bradford M. Van, and Michele I. Naples. 1164.

¹² Nersisyan, Yeva, and L. Randall Wray. 5.

false indicators that the financial sector is suffering and needs intervention from the United States government has allowed it to become too powerful and hold too much market power. The increased influence that the financial sector has obtained is significant in economic stability. The Revenue Act of 1914 aimed to curb speculative tendencies with a tax on stock trades and although it was effective in increasing tax revenue, it was removed fifty year later to improve the financial sector, promote greater purchases in the financial market, and reform the tax system.¹³

The removal of this tax allowed for greater participation in the stock market and purchasing of financial assets, but it created more instability in the financial sector. In a vacuum, this should have been an overall positive for the economy because it should have induced public investment and the expansion of industry. Because of other failures within the economy that followed the removal of the Revenue Act, manufacturing was no longer a source of profitable investment and stagnation made industry less appealing.¹⁴ The lessened appeal of industry lost the funding of investors because of the inability to obtain quick profits and lack of policy protection for these firms.

1.10: Policy Implications on Economic Agents

Investors are less willing to invest and support the survival of non financial firms when the government is funding corporations. The widespread decline of sales in the

¹³ Thorndike, Joseph. "Speculation and Taxation: Time for a Transaction Tax?" Tax History. Org. September 26, 2008.
<http://www.taxhistory.org/thp/readings.nsf/ArtWeb/6062A8E3B6C9C7C585257480005BFEE6?OpenDocument>.

¹⁴ Foster, John Bellamy, and Fred Magdoff. "The Financialization of Capital and the Crisis: April 2008." In *The Great Financial Crisis: Causes and Consequences*, 91-110. NYU Press, 2009.
<http://www.jstor.org/stable/j.ctt1657t2c.9>. 102.

1970's paved the way for relaxed regulation in the next decade that began the dramatic rise of financialization.¹⁵ The energy crises that occurred during this decade perhaps affected the nature of economic agents to hoard financial assets in fear that they were more liquid. Regulation in the next decade was created to support the accumulation of financial assets that caused corporations to evolve into financial institutions.

The development of the financial sector in the 1980's is critical in the development of financialization because it paved the way for deregulation and increased market concentration within the financial sector. The heavily inflated corporations viewed small firms as a burden to profit-maximizing agents and only a source of profit when the firms is dissolved.¹⁶ Policy needed to create financial intermediation that would reverse these trends , but firms were dismantled to maximize profits within the financial sector not improve efficiency within the entire economy. Although efficiency was not directly the issue, the restructuring of firms caused inverse reactions such as the increased wage gap and decreasing labor share that forced firms to borrow to survive.¹⁷ The lenient regulation that occurred at this time forced firms to take out loans they could not afford so they would go under and merge with larger firms to form financial institutions.

1.11: Financialization Revitalized

¹⁵ Davis, Leila E. "Identifying the "financialization" of the Nonfinancial Corporation in the U.S. Economy: A Decomposition of Firm-level Balance Sheets." *Journal of Post Keynesian Economics* 39, no. 1 (2016): 115-41. doi:10.1080/01603477.2015.1116370. 126.

¹⁶ Davis, Gerald Jerry F., and Suntae Kim. 13.

¹⁷ Tabb, William K. "Financialization and Social Structures of Accumulation." In *The Restructuring of Capitalism in Our Time*, 25-59. Columbia University Press, 2012. <http://www.jstor.org/stable/10.7312/tabb15842.5>. 32.

The formation of financial institutions during financialization occurred when firms merged after they could not pay off their debt. This created the biggest wave of economic agents purchasing the CDOs of smaller firms in order to obtain market power and remain profitable as a financial institution. As the antitrust movement of the early 20th century was essential in reducing market concentration and avoiding the creation of large corporations, the election of Ronald Reagan in 1980 signified the end of antitrust ideals within the financial sector.¹⁸ These ideals ultimately resulted in the reduction of almost a third of Fortune 500 companies due to mergers or acquisitions that contributed to the weakened diversification of American corporations.¹⁹ The decreasing diversification of supply indicated a stagnation of growth.

1.12: Financialization and the Creation of the New Business Cycle

The recent Economic report published by the last president is somewhat alarming because of decreasing firm interactions. The fall in 10 year investments will affect consumers on all levels because of the lessened access to credit. The decreasing access to credit is a negative development in business and industry because it indicates that investment is being funnelled away from firms and towards financial assets that do not support job creation or job stability. Although President Obama does not directly address financialization, there is a direct correlation for job loss or firms deaths, combined with the spread of financialization.

¹⁸ Davis, Gerald Jerry F., and Suntae Kim. 13.

¹⁹ Ibid.,

The business cycle has been affected because investment spending has grown slowly. The lack of spending affects the real economy because there is a surplus of capital services relative to output since the last recession.²⁰ This is a dual sided problem because investment spending is low and thus output is hindered because of it, so the dilemma is understanding where exactly the money has gone. In order to increase the overall output in the economy this money needs to be reinvested in real goods and services. The correlation between finance and output are sometimes misleading because the economy is perceived to be doing very well, but the implications of finance are multifaceted. The decreasing labor share outside of the financial sector since the 80's represents an economy that cannot support itself. The growth that the financial sector has sustained solidifies the need for a redistribution of wealth through a greater regulation of financialization.

1.13: Financialization Weakening Job Creation

Financialization has weakened job creation and created a need for the redistribution of wealth because of declining jobs in the goods and services. Combined with the favoritism the financial sector has towards large firms, the disappearance of small firms has caused widespread job loss. Increased regulation is needed to reduce the influence of financial institutions, which can be seen in the National Economic Report from President Obama that noted lower levels of fluidity in the labor market,

²⁰ United States. Congress. Joint Economic Committee,. The Economic Report of the President: Hearing before the Joint Economic Committee, Congress of the United States, One Hundred Fourteenth Congress, First Session, March 18, 2015. 75.

representing a reduction in growth.²¹ The reduction in growth is seen in the decline of the production sectors and labor market within the sector. It is probable that workers are becoming more skilled and there is less fluidity in the market because workers are not changing jobs as prevalently, but this does not replace the jobs that were already lost. The job market is not strong in an economy that relies on financialization as a contributing source of profit because jobs are only introduced into specific sectors. The reduction in total number of firms from multiple sectors throughout the economy support the notion that fewer jobs are created from these sectors.²² This is a significant indication that job and firm creation outside the financial sector may not be as stable.

1.14: Increased Pattern of Risk

The overall size of firms and their status as financial or nonfinancial corporations is a greater impact and implication of financialization because it marginalizes certain firms and has shifted the goals of others. It has become a problem because corporations that once focused on outputs, their success in manufacturing outputs, and the profitability of them has been abandoned in favor of the methods used by shadow banks and financial corporations. The lack of responsibility that borrowers now have to undertake, has caused the shadow bank to loan to those without positive credit and create a need for financial intermediation again.²³ This is essentially how the financial sector has stayed relevant because despite the wavering need for financial intermediation, the actions of the financial sector has allowed it to control the rest of the

²¹ Ibid., 130.

²² Ibid., 139.

²³ Nersisyan, Yeva, and L. Randall Wray. 9.

economy and remain profitable. Although these tendencies are crippling the economy in some regards, because the economy has recovered in recent years, the shadow banking system has been somewhat ignored because of the false perceptions of prosperity. It is important to recognize the rise and fall of the financial sector because it dictates the future development of it and the development of business in the United States.

1.15: Protection of Financial Industry

The overall rise of the financial sector and its impact on the business cycle has not supported the creation of new firms and non-financial firms. Firms are finding it increasingly difficult to create business through the service they provide because profitability is generated through financial assets. Palley outlines this as one of the factors in the creation of the new business cycle that does not support labor markets or employment, but protect financial assets so the financial sector does not collapse.²⁴ The support of the financial sector represents a business model that does not support the consumer or business owner. It only supports economic status of the lenders who have acquired financial assets to increase their internal profits.

The historical context of the financial sector is important to recognize because it shaped the future regulation of the market. The lack of regulation that has taken place in the last half century has caused the market to become independent of regulation so the market has not experienced any distinct collapses despite the collapses that have occurred to non financial markets in the United States. The lack of regulation is crucial

²⁴ Palley, Thomas I. "Financialization: What It Is and Why It Matters." *Financialization*, 2013, 1-30. doi:10.1057/9781137265821_2. 125.

to study because it has allowed the financial industry to grow to unprecedented levels and as a result hindered the firm and the consumer.²⁵ Although it can not be concluded that financialization had a direct and negative impact on firms and households, the fall of other sectors in the United States economy contributed to the shift away from industry.

1.16: Decline of Production

The shift away from industry is mainly focused on the lack of profitability from real goods and services produced in the economy. This has been replaced with short term profit maximizing techniques developed by the financial industry. This can be observed in the fall of industrialization and the rise of automobiles, information technology, pharmacy, and the internet.²⁶ It is important to study the rise and fall of specific industries because they have direct correlations with demand, firm creation, and job creation for the overall economy. Although this may be presented as a macroeconomic dilemma, there are microeconomic implications that can not be directly observed. Measurements within the financial market compare it with other sectors showing the implications of the financial sector.

The understanding of the United States financial sector extends far beyond the role it has in the stock market, but its market power and the spheres of influence that financialization has on the economy as a whole. There is a critical shift in economic models that can be blamed on the influence of financialization in many sectors of the

²⁵ Kedrosky, Paul, and Daniel Stangler. 5.

²⁶ Ibid., 7.

economy. From a macroeconomic standpoint financialization has shifted utility and the labor leisure trade-off. This has shifted the supply and demand of firms and consumers as well. The hoarding of capital and capital assets in the financial industry has increased the propensity to save. The propensity to save has not correlated with a rise in utility because consumers and individual firms have been ignored in favor of stockholders. The shift in investment will not occur naturally, but a renewed focus is needed towards labor and a decreased focus on financial intermediation within the sectors of the economy that do not profit from it.²⁷ The return to real investment and production will not only expand firm creation and increase labor share, but also diversify the economy once again.

²⁷ Stockhammer, Engelbert. "Financialization, Income Distribution and the Crisis." *Investigación Económica* 71, no. 279 (2012): 39-70. <http://www.jstor.org/stable/42779220>. 64.

Chapter 2: Perspectives of Financialization

2.1: Financialization Represented in Growth

The shift away from the success and growth of consumers and firms towards stockholders is primarily related to the profitability that has arisen from the short term purchases and sales of financial assets. The assets that financial institutions are now using to measure their profits include stock purchases, but have expanded to a variety of financial assets including subprime loans, CDOs, junk bonds, and the financing of nonfinancial firms. Financialization is widespread and it has encroached on small firms that previously did not have any connection to finance.²⁸ This has impeded overall economic growth because the need to increase sales has been compromised in favor of the accumulating financial assets. The decline in sales and investments have prevented from from innovating to increase their profitability.

Innovations have occurred more readily in the financial sector because the sector has now prioritized profits and rapid growth. The business model has shifted to reflect this because of the need for retained earnings and investments to support

²⁸ Davis, Gerald Jerry F., and Suntae Kim. 20.

stockholders.²⁹ The shift from the consumer to the stockholder is an important development because investment no longer represent consumer needs. The study of investment over the past few decades shows the accumulation of financial assets exceeding the domestic investment of firms in the United States.³⁰ This trend negatively affected the firm and the consumer, but also decreased the supply of capital stock. The reduced holdings of capital stock signals the fear in industry and the potential collapse that could occur.

2.2: Financial Market Instability

The strict accumulation of capital stock would normally not be a great indicator that firms are suffering due to financialization, but the accumulation of financial assets that coordinate with the fall of it only support financial growth. L.E. Davis' graph of financial assets and capital stock relative to sales indicate that firms availability of capital stock has declined in the last half century and the percentage of financial assets has almost doubled.³¹ The dramatic accumulation of financial assets is potentially more troublesome, as the methods used by the financial sector to conceal their activity is hiding their total impact. In other figures the assets that were once divided into simply capital stock or financial assets can be deviated more specifically to understand the behavior of the NFC's.

²⁹ Lazonick, William. "Innovative Business Models and Varieties of Capitalism: Financialization of the U.S. Corporation." *The Business History Review* 84, no. 4 (2010): 675-702. <http://www.jstor.org/stable/27917307>. 687.

³⁰ Milberg, William, and Deborah Winkler. "Trade Crisis And Recovery : Restructuring Of Global Value Chains." *Policy Research Working Papers*, 2010. doi:10.1596/1813-9450-5294.

³¹ Davis, Leila E. 119.

The increased accumulation of financial assets have been widespread in the economy, but the specific assets accumulated by NFC's had a negative impact on firm growth. The assets accumulated by smaller firms have not been direct purchases of financial assets, but focused on short term securities and stock purchases.³² The trend towards short term investments is widespread in the economy, but it negatively affects overall growth. The profit accumulation for the highest earners in the economy has focused on the rapid process of investment and collecting returns, which has ignored essential phases of growth. The unnatural growth created disturbances in the business cycle aiding to rising inequality. The increasing levels of inequality are significant and seen in the lack of growth outside the financial sector.³³ The improper policy measures have only contributed to the unstable financial sector and limited the influence of small firms.

2.3: Characteristics of Financialization

The firms have deviated into two groups in response to the growing trend of financialization because it has impeded growth for both large and small firms regardless of the firm's connection to finance. Some of these firms have benefited from financialization because it has allowed them to use the accumulation of financial assets to generate profits. The accumulation of financial assets and the shift in firm behavior is a macroeconomic problem that is relevant on the microeconomic scale. Larger firms have been able to open their own lines of credit for their customers and this has

³² Ibid., 121.

³³ Lin, Ken-Hou, and Donald Tomaskovic-Devey. 1293.

become a new source of income for these firms. Larger firms that have a high velocity of sales and transactions are benefitting from the credit and loans taken out to purchase goods and services from the firm. The issuance of credit and stock options by large firms make it more difficult for smaller non financial firms to survive.³⁴ If they are forced to sell off their debt to financial institutions, they have lost their market power and are no longer in control of their business. The firms remain unprofitable, but owners still owe money to creditors as they control the firms.³⁵

2.4: Financial Institutional Influence

The influence of the financial sector has grown to represent its own economy, as it grows when other areas are unsuccessful. Unsuccessful firms attract creditors because the firm owner will not be able to escape their debt and will continue to pay interest. This is enforcing the current wage gap that is forcing workers to the bottom of the labor market and the return of debtor's prisons.³⁶ The financial bubble does not concern the financial sector because of their ability to be bailed out. Financial institutions that are seen as "Too Big to Fail" do not regret depleting other sectors of the economy and are bailed out despite their lack of functionality.³⁷

The accumulation of debt and credit is only making it easier for these institutions to exploit firms. It has allowed profits to be taken through sales and anything bought on credit generates interest for the firm. The ability to do this and rely less on sales has been a huge tool for firms to accumulate capital and not go bankrupt in periods of

³⁴ Lazonick, William. 695.

³⁵ Tabb, William K. 52.

³⁶ Davis, Gerald Jerry F., and Suntae Kim. 21.

³⁷ Nersisyan, Yeva, and L. Randall Wray. 24.

financial uncertainty. Although this supports large firms and allows them to continue to be profitable, this shift has hurt the development of non-financial small firms because of the control financial institutions are displaying over them.

2.5: Financialization of NFCs

The focus on non-financial small firms is crucial for economic growth for multiple reasons. The focus on small firms with less than 500 employees has been the focus of American business for decades and the recent shift to finance is not guaranteeing long term success.³⁸ In the past, the United States government has made an effort to support small firms and protect their overall survival, but financialization has questioned the survival of small firms. The small firms offer multiple incentives and reasons why they should remain a pivotal part of the economy in favor of an economy rooted deeply in financialization.

The movement to support small firms, as opposed to larger firms taking part in financialization is a deeper issue than overall sales, but the individual results that have coincided with the decline of small firms. This represents an indicator of economic instability because smaller firms are able to grow more rapidly.³⁹ Smaller firms have been beneficial because of the lessened risk involved with them and the widespread demand they offer. The ability for smaller lenders to devote a greater portion of total assets to the creation of small firms has made them favorable because of the potential continued funding of them. The corporate lenders have engaged in other financial activities involved with shadow banking and their direct allocation of assets to small

³⁸ Sahin, Aysegul, Sagiri Kitao, Anna Cororaton, and Sergiu Laiu. "Why Small Businesses Were Hit Harder by the Recent Recession." SSRN Electronic Journal. doi:10.2139/ssrn.1895527. 1.

³⁹ Ibid., 3.

businesses are deviated. The nonfinancial corporations are no longer considered essential to the economy so the financial institutions are strengthened. The direct lending to fund NFC's has decreased overall production in the economy. Financial institutions have replaced this share in the economy with long term impacts on debt, wages, job creation, and existence of firms within the economy.

Table H. Ratio of Total Small Business Loans to Total Assets, 2008-2013
(percentage)

Lender Size	2008	2009	2010	2011	2012	2013	Change 2012 - 2013	
							Difference	%
Lenders by Total Asset Size								
Less than \$100 million	15.94	15.82	15.36	14.65	14.10	13.69	-0.41	-2.9
\$100 million to \$499.9 million	17.94	17.43	16.72	15.94	15.25	14.98	-0.27	-1.8
\$500 million to \$999.9 million	14.63	14.06	13.78	13.04	12.35	12.34	-0.01	-0.1
\$1 billion to \$9.9 billion	11.48	10.75	10.21	10.05	9.60	9.54	-0.06	-0.6
\$10 billion to \$49.9 billion	6.18	6.53	6.07	5.48	5.29	5.17	-0.12	-2.3
\$50 billion or more	4.48	4.84	4.68	3.75	3.64	3.44	-0.20	-5.6
Total Small Business Loans	16.27	15.89	15.34	14.63	14.00	13.72	-0.28	-2.0

Source: Federal Deposit Insurance Corporation, Statistics on Depository Institutions, June 2008 through June 2013.

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2.6: Financialization Weakening Creation of Small Firms

The versatility offered by smaller firms is essential to the stability of the economy because it is much easier for the government to regulate and control. Larger firms and corporations are more independent from government regulation because of their market power. Despite larger corporations acting independently, the existence of small firms is necessary because of their ability to create jobs. The increasing number of small firm deaths has reduced investment in them because of lower consumer demand despite their ability to create jobs.⁴¹ Although it is presented that investment fell because

⁴⁰ SBA. 2016.

⁴¹ Ibid., 6.

consumer demand fell, it is more plausible that the reverse is true because of increasing inequality stifling demand. The lack of investment towards these small firms have caused the government to realize the phenomenon of small firm job creation. This is reflected in the need to protect small firms with legislation such as the Small Business Act in 1953 to help fund and promote the overall success of small business.⁴²

2.7: Survival of Small Firms with Financialization

The benefits of small firms that existed prior to financialization is a reason why the Small Business Act was enacted and still supported in present context. The initial motive behind the Small Business Act was aimed at funding and protecting the overall success of small firms in a growing economy.⁴³ In the 1950's strip malls and box stores began to emerge and their survival was threatened because of the competition they faced. The ability to have more competitive pricing or offer a greater selection of goods is a reason why small firms have disappeared at an alarming rate because of the financial versatility of the larger firms. Although larger firms may offer more versatility to the consumer in terms of selection from a single firm, smaller firms cater to niche demands and have the greatest job creation for any sized firm.

It was noted that following the creation of the Small Business Act that smaller firms have been much better at creating jobs with firms with less than twenty employees creating roughly ⅔ of all jobs in the economy and firms with less than 100 employees

⁴² Mandal, Arindam, and Mankirat Singh. "Do Small Businesses Create More Job? Evidence for New York State." NYSEA Proceedings 7:119-30. 120.

⁴³ Ibid.,

accounted for over 4% of overall job creation.⁴⁴ Prior to financialization, the small firms were pivotal in job creation because of the stability and dilution of small firms throughout the country. Small firms are much more efficient in connecting consumers throughout the country because of the total number of smaller firms that exist. The smaller size of employment and lower overhead needed to create a small firm supports their stability, but also the success of small firms for future economic growth.

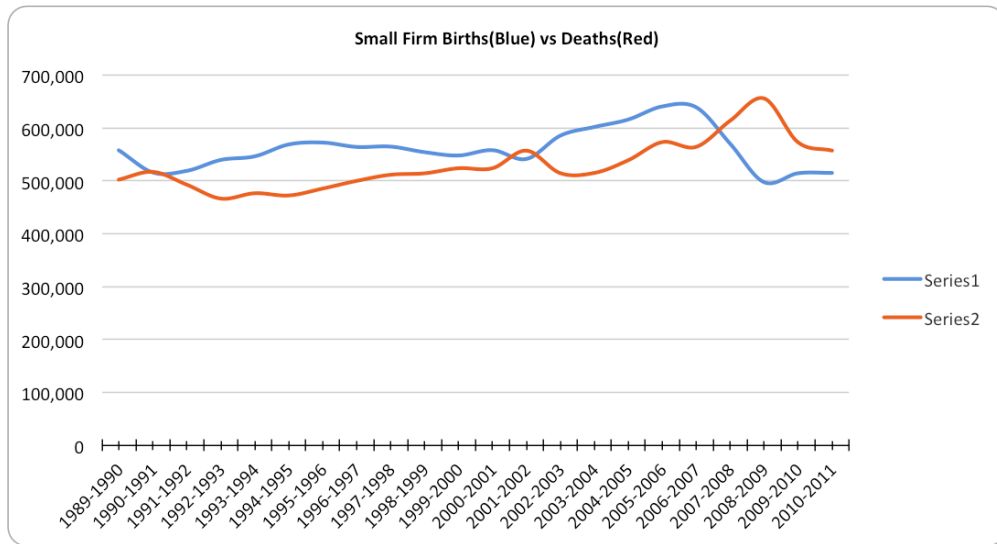
2.8: Financialization and Firm Deviation

The variation between small firms and large firms in terms of economic stability supports small firms much more than larger firms because of the threat of financialization. Financialization has skewed the nature of firms to cater to financial institutions rather than the consumers and employees who benefit from the success and survival of firms. This is a primary reason why President Obama has shifted his focus to support small firms in the Small Business Jobs Act to increase the total firm births of small firms through increased loans and decreased fees to support the creation of smaller firms in the United States.⁴⁵ This act is crucial in the long term success of small firms and business in general because of recent trends that support financialization and not the overall success of the economy. Without investment and support from the entire economy, regulation made by the president will not save small firms because financial institutions need to be stop their current activity. Financial intermediation is not what is killing small firms, but the unregulated behavior of institutions conducting the

⁴⁴ Ibid., 121.

⁴⁵ Ibid., 120.

intermediation. This does not directly label financialization as an absolute negative for the economy, but the way supporters of financialization have gone about it will create long term economic failures. The greater number of firm deaths indicate the falling support for small firm survival.



2.9: Financial Sector’s Market Power

The failures of the financial sector can be observed in the most recent financial crisis because of policies such as “Too Big to Fail” that have supported institutions that have engaged in the negative aspects of financialization creating instability. The policies that have supported large corporations do not explain the incredible losses these institutions take (11 billion) versus the bonuses they took (33 billion) in 2007.⁴⁶ This fact explains the growing level of inequality in the United States economy because these institutions are simply able to exploit the rest of the economy. The reliance on large corporations not only places too much market power in the hands of untrustworthy economic agents, but it relinquishes the market power for small firms. The small non-

⁴⁶ Tabb, William. K. 51.

financial firms are no longer a stable investment because the propensity of corporations to acquire small firms has shortened firm life expectancies.⁴⁷ Although the financial corporations do not always have a direct impact on the deaths of small firms, the allocation of capital and increased competition that's resulted because of financialization can be an indicator of the negative relationship.

2.10: Measuring the Growth of the Financial Sector

The rapid development of financialization makes it an under-studied topic outside of economics because it is not easily measurable with clear indicators of its impact. Financialization was first observed as the percentage of financial assets with respect to GDP and its overall rise is not unprecedented. The comparison of financial assets to other sectors within the economy show that it is growing rapidly and could be unsustainable.⁴⁸ The broad based measures of financialization and lack of understanding over measuring of it do not allow it to be fully quantified. A possible reason for this, is the emergence of the shadow bank over the past few decades that has accumulated upwards of 15 trillion dollars and starved other sectors of the economy from much needed investment.⁴⁹ The impact from this can be witnessed and further measured through the impact on sales and investment across various sectors. Although measuring financialization through financial assets as a percentage of GDP presents a macroeconomic issue, it shows indicators for the rest of the economy.

⁴⁷ Davis, Gerald Jerry F., and Suntae Kim. 27.

⁴⁸ Krippner, G. R. "The Financialization of the American Economy." *Socio-Economic Review* 3, no. 2 (2005): 173-208. doi:10.1093/ser/mwi008. 180.

⁴⁹ Kedrosky, Paul, and Daniel Stangler. 4.

The evolution of financialization with respect to GDP over the course of over a century shows not only sustained financial sector growth, but also specific periods with surges in the market. The overall evolution allows for more specific measurements to be taken and studied at individual moments that include the percentage of sales, investment, consumer debt, firm creation, and job growth for the economy as a whole. It is necessary to compare this figure across sectors because employment is falling in certain sectors.⁵⁰ Studying financialization as the variation across sectors allows one to understand where financialization has the biggest impact. Because financialization is hypothesized to decrease real output of goods and services, understanding the rise and fall of financial assets, as a percentage of GDP will begin the narrative on the specific effects it's had.

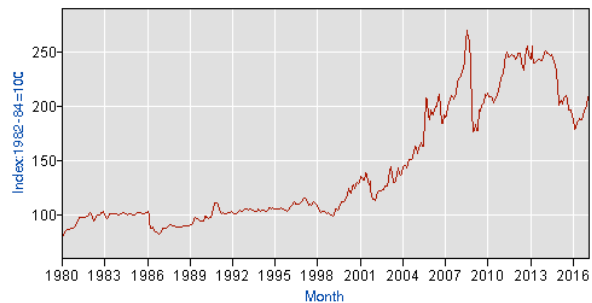
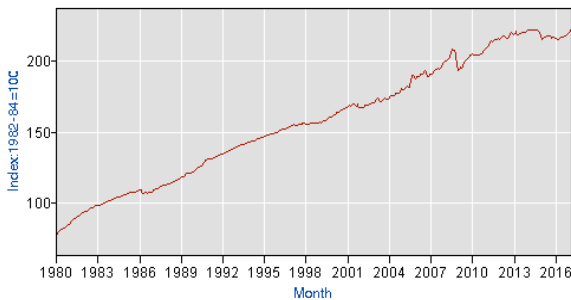
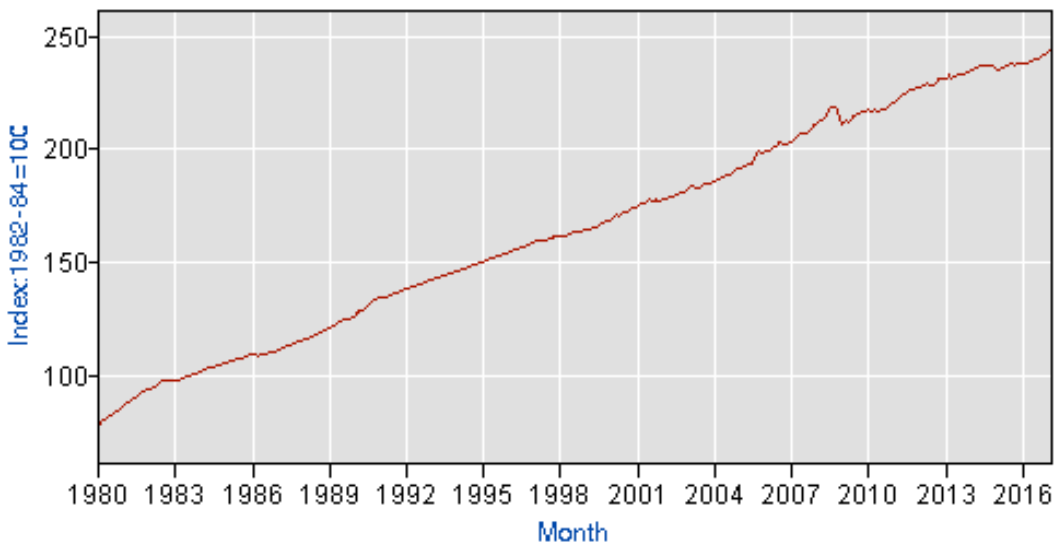
2.11: Financialization Limiting Sales

Financialization has crowded out the production of real goods and services shifted the supply and demand within the economy. The first factor that has affected the overall number of sales is decreased supply because of funds going to the financial sector. The ability to consume financial assets has allowed investors to rely less on sales and more on their ability to control and manipulate financial assets.⁵¹ Investors have not needed to invest directly in business in order to profit, but the purchase of financial assets has replaced the need for greater sales. There are several reasons for financialization causing the decrease in sales, mainly because of a shift in utility that has favored the financial sector. Utility has decreased because it has not maintained

⁵⁰ Krippner, G. R. 178.

⁵¹ Foster, John Bellamy, and Fred Magdoff. 102.

financial stability and labor share has decreased despite the rise of earnings per share in the financial market.⁵² This has contributed to the decline in sales because of the shift away from small firms. The three graphs measure total sales employment in the top graph, production of goods and services in the bottom left, and the energy output in the bottom right graph. The build-up of financialization has allowed the financial sector to grow while starving other sectors of the economy of necessary funding after the last crisis.



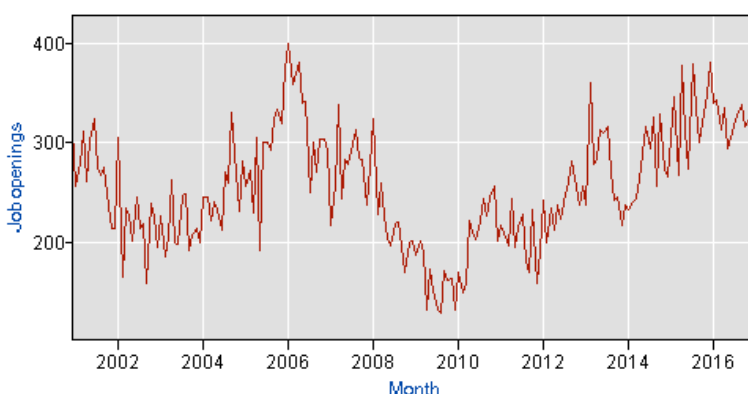
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⁵² Lazonick, William. 692.

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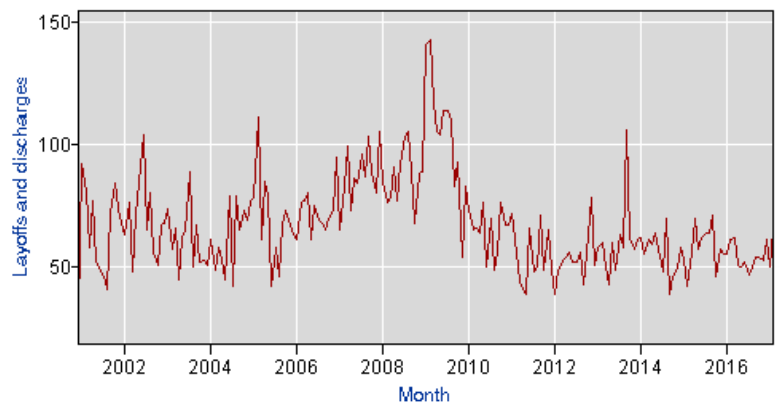
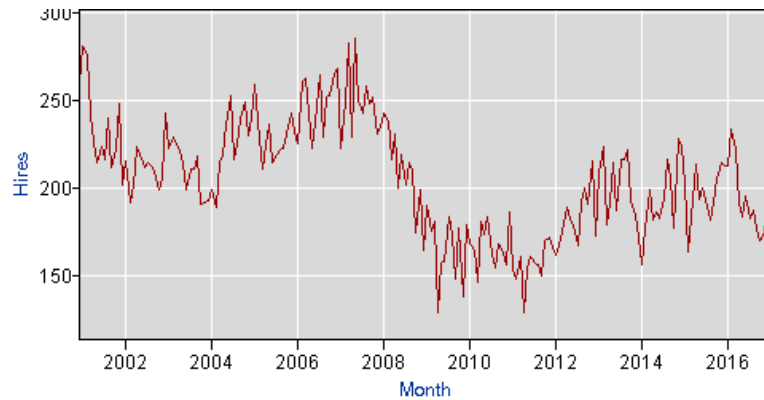
2.12: The Financial Sector's Inability to Maximize Job Growth

Financialization has decreased sales and forced the slow-down of job creation within certain sectors of the economy. The overall decline in job creation for certain sectors of the economy can be contributed to the growing shadow banks in the financial sector that have crowded out real investment.⁵⁴ The crowding out that has taken place can be related to sales and investment that only creates profits and jobs for the financial sector. For example, the financial sector represents 25% of corporate profit, but it only represents 4 % of jobs in the economy.⁵⁵ Job creation has certainly grown in the financial sector, but other sectors in the economy have been compromised in order to continue the evolution of the financial market. The slowdown of growth in other sectors is more significant because of the smaller labor market created by the financial sector. This graph represents the total hires in the financial sector and it shows the slower job creation compared with production industries. The hires in industries producing real goods and services have fallen from historical marks, although the industry is much more stable as it retains a greater portion of its workforce in the bottom two figures.



⁵⁴ Sahin, Aysegul, Sagiri Kitao, Anna Cororaton, and Sergiu Laiu.4.

⁵⁵ Kedrosky, Paul, and Daniel Stangler. 7.



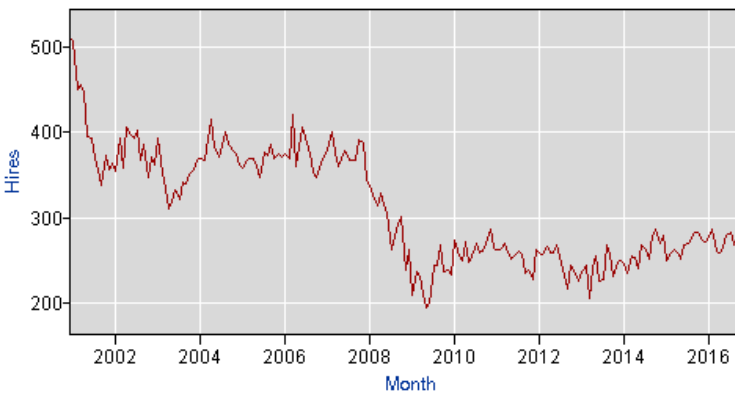
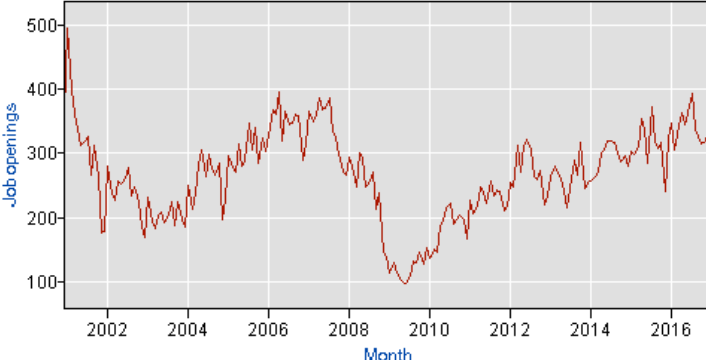
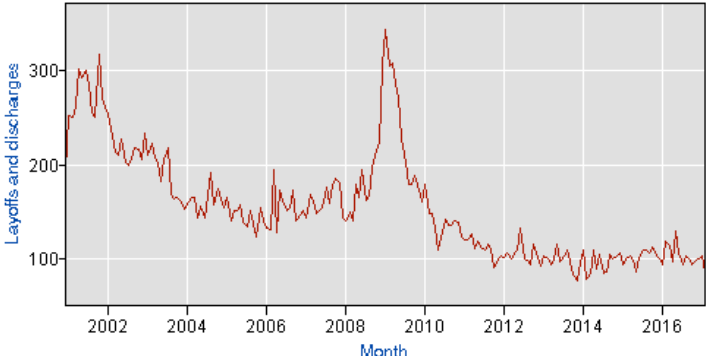
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This indicates the inability for job creation to be maximized in the financial industry because of the smaller labor share of the industry. Over forty years ago when manufacturing represented the largest industry in the country, at 40% of GDP, it represented 20 % of jobs in the economy, compared to the financial industry of today that represents a similar labor share, but it only created a quarter of the jobs that the manufacturing sector did.⁵⁷ The variations in wages that would be typical for the financial versus manufacturing sector, combined with more skilled jobs in the financial sector contributed to the fewer job offerings. The decline in job creation has caused some members of the economy to be crowded out and unable to obtain a job because of

⁵⁶ Bureau of Labor Statistics. Graph Johnson. 2017.

⁵⁷ Arnum, Bradford M. Van, and Michele I. Naples. 1161.

the financial sector. This shift has altered the job market and shifted the nature of investment in firms. Firms that produce real goods and services are abandoned so assets can be deviated to the financial sector, although the production sectors are recovering and growing. These figures represent the falling layoffs in the production sector and more job openings, but fewer hires because of financial sector influence.



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⁵⁸ Bureau of Labor Statistics. Graph Johnson. 2017.

2.13: Financial Investment in Real Goods and Services

The third factor that correlated with the rise of the financial sector is the development of financial assets to induce further investment in them. Investments normally existed in a distinct divide between real investment and financial investment, but in the last forty years they have existed as substitutes for each other.⁵⁹ Financial versus real assets may exist as substitutes for each other, but this creates a bias in regards to what is more profitable. This has altered the position of firms and investors because it changes their natural behavior to use profit-maximizing strategies in business and innovation. The risky behavior that corporations have engaged in would translate to better efficiency if firms were less risky.⁶⁰ The practice by investment banks to encroach into the financing of individual consumers has exceeded its market reach. It was crowded out the real goods and services of relation lenders that focus on small firm survival, as opposed to profits sought by larger banks.

Although economic agents still use profit-maximizing strategies, these strategies have cater to the financial sector, not the most profitable sectors producing real goods and services. The increasing wage gap has caused industry to be unaffordable because sales have declined and rentier capitalists only fund growth for profit.⁶¹ Financial investment has been viewed as a safe substitute because of the ability to obtain equivalent profits, but also assets can be more liquid leading to a higher velocity of sales for financial assets. The liquidity of these assets opposed to capital investment is significant because of the velocity in trading these assets has allowed “flash trading” to

⁵⁹ Orhangazi, Özgür. 866.

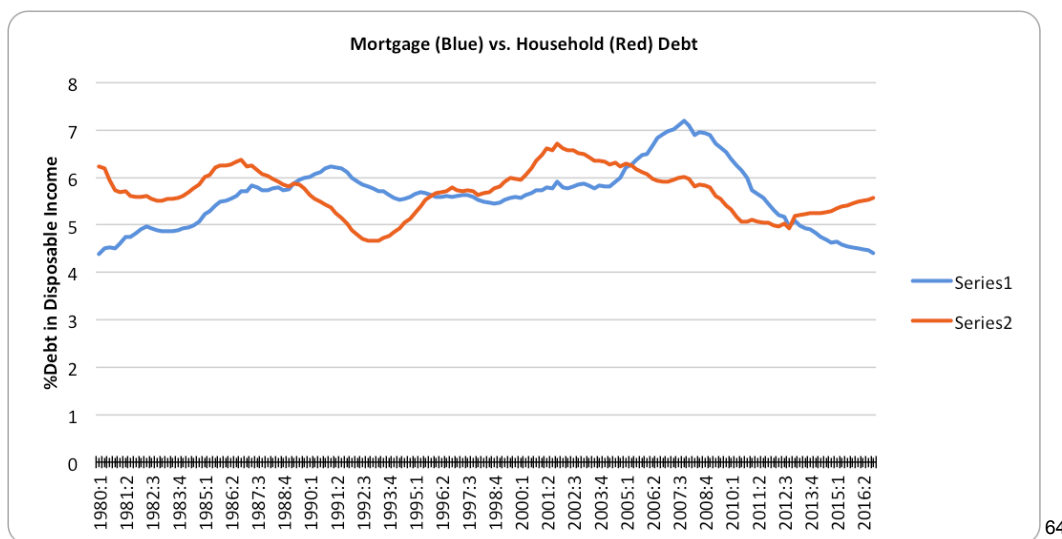
⁶⁰ Philippon, Thomas. 242.

⁶¹ Davis, Gerald Jerry F., and Suntae Kim. 17.

emerge.⁶² This supports why the financial sector has grown, but is unable to maintain stability for small firms. The rigid nature of capital investment and the time that it takes for an investment to reward the shareholder with profits is an indicator of financial institutions avoiding these long-term investments.

2.14: Financialization Raising Consumer Debt

Financialization contributed to the recent economic crisis by raising mortgage debt because of the sub prime loan bubble and subsequent crash of the real estate market. The crisis has been ameliorated and mortgage debt has fallen, but financialization has caused consumer debt to steadily rise. In the period following the the crisis, the ratio of capital investment to financial assets is shrinking so financial institutions are growing and consumer debt is rising again.⁶³



⁶² Davis, Leila E. 118.

⁶³ Lin, Ken-Hou, and Donald Tomaskovic-Devey. 1285.

⁶⁴ SBA 2016. Graph. Johnson 2017.

On a macroeconomic level the growing debt is an indicator of the wage gap that exists because of financialization weakening non-financial sectors of the economy. The debt expands the wage gap because of fewer jobs in the production of goods and services combined with the return of fewer jobs in the financial industry. Although some sectors have grown, the large declines in the manufacturing, transportation, and construction industries have caused the labor share of national income to fall 6% since the 1970's.⁶⁵ This is represented in consumer debt and the wage gap because the loss of firms and jobs in these sectors has forced many people to support large firms. Rising consumer debt correlates with the favoritism towards large firms that have cheaper prices because of cheaper labor. Financialization has helped create large firms to supplement the consumer debt that rises with the shrinking job market. Those who benefit from the increase in jobs in the financial industry are also likely to benefit from the increased profitability of financial assets too, with $\frac{3}{4}$ of all stock trades of financial assets done by institutional investors.⁶⁶ This dismisses the notion that the financial sector is not exclusive and benefits the entire population. The nature of stock and financial asset accumulation has only contributed to a growing wage gap and inequality. Consumer debt is consistent throughout the period of financialization representing speculation and fluctuation of consumer utility.

⁶⁵ Ibid., 1289.

⁶⁶ Lazonick, William. 697.

2.15: Financialization Raising Inequality

The financial sector is prone to inequality because of its nature to reward CEOs and shareholders not the businesses represented by financial assets. The shift in income share is much more severe when compared to the scope of the economy because of the earnings in corporations that have grown as much as 370%.⁶⁷ Although the widespread division of income share is not quite as severe, the division certainly exists and between college graduates and non graduates. In the 1970's those who did not have a degree earned 30% less and this figure doubled over the next few decades.⁶⁸ This is an issue of inequality because adults who do not have a college degree are more prone to decreased wages and job loss versus those with a college degree.⁶⁹ This further emphasized the paradox that exists in the augmentations of the financial sector because workers that lost jobs in other sectors could not get new jobs in the financial sector without a college degree. Although some viewed the increased size of the financial sector as a positive because it showed growth in the economy, the exclusivity that existed within the financial sector ultimately raised consumer debt through inequality.

2.16: Financialization Impact on the Labor Market

Financialization has raised inequality because of the loss of jobs for workers within the bottom 50% of the economy. The shift in jobs and total small firms between sectors has decreased output in the economy because of a lack of spending from the

⁶⁷ Lin, Ken-Hou, and Donald Tomaskovic-Devey. 1289

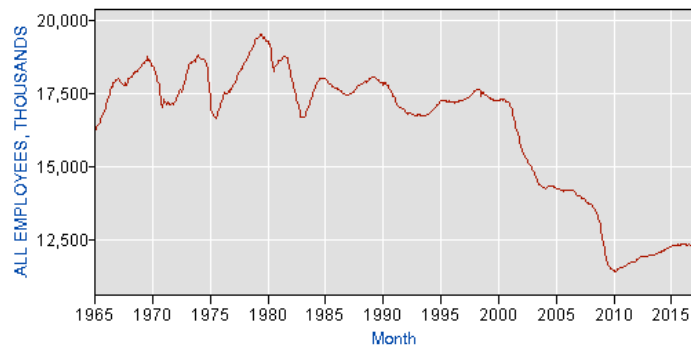
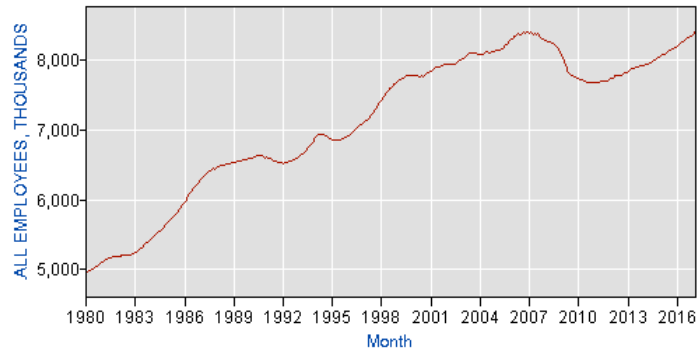
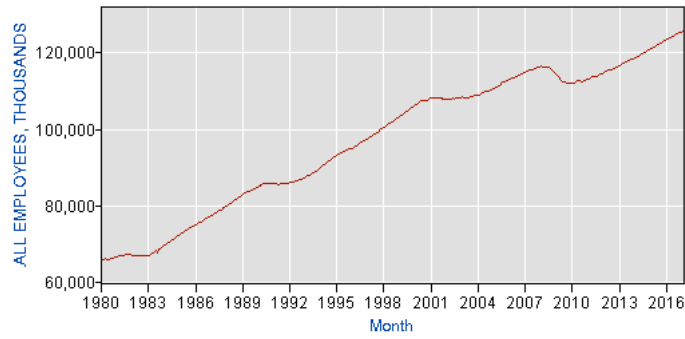
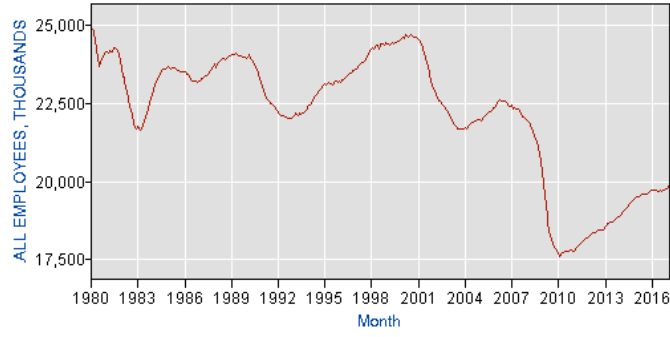
⁶⁸ Ibid., 1290.

⁶⁹ Arnum, Bradford M. Van, and Michele I. Naples.1171.

bottom 50% of the economy. The need for labor market reform is a pressing issue because of the inability for the market to correct itself. The lack of regulation causes the market to falter, because increased regulation is needed to reduce the influence of financial institutions. In the National Economic Report President Obama noted lower levels of fluidity in the labor market, as a potential issue and reason for the reduction of growth.⁷⁰ Financialization has caused job creation to fall because of financial investments creating more employment births than deaths, and low fluidity in the labor market still suggests instability. It is also probable that workers are becoming more skilled and thus there is less fluidity because workers are not changing jobs as prevalently. Although this could be the case, it is also noted in the report that overall firm rates of entry and exit have declined⁷¹ indicating that jobs and job creation may not be as stable as perceived. The economy that has a declining rate of unemployment may indicate that the labor market is stable and financialization may not impact it, but the growth or loss of jobs in specific sectors that produce goods show this is not the case. Total employees in goods producing firms have fallen according to this figure because of the reduction in total firms slowing job growth. This is conflicted by the figures below it that show the total number of employees in the service sector growing, mainly because of the employees added by the financial sector in the third figure. Other services are falling because of the financial sector growth that is seen in the fourth figure.

⁷⁰ Ibid., 136.

⁷¹ Ibid., 139.



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⁷² Bureau of Labor Statistics. Graph Johnson 2017.

2.17: Financialization Limiting Technology

Inequality generally has the biggest impact on those who are the lowest earners in the economy, but financialization has negatively affected technology and innovation as well. The negative implications that have occurred slowed growth, but also impeded future innovations because of lack of investment from the financial sector. This is rooted in the shift from lending to speculation that has occurred in the 70's.⁷³ This does not solely impact the technology sector, but it has reduced investment in the technology sector to disallow new firms and more importantly new technology to increase efficiency. Technological advancements are essential for the economy because of their ability to increase efficiency and ultimately create new jobs in the economy. Although increased technology has replaced certain jobs, the overall investment in technology is crucial to avoid stagnation and maintain job growth.

2.18: Financialization Limiting Innovation

Stagnation can be avoided through increased investment in technology, but because of the recent focus on the accumulation of financial assets, technology firms are not receiving the funding they need to innovate. It has been positive for a company to go public in order accumulate investment and increase the size of it, but recently, new technology startups are not being funding. Recent data shows that it is economically more efficient to stay private because of the 40% reduction of innovation when a company goes public.⁷⁴ The reduction in innovation by such a large proportion

⁷³ Lazonick, William. 693.

⁷⁴ Krippner, G. R. 196.

of the economy should influence economic agents to avoid going public. Although investment may rise once a company goes public, the tradeoff that takes place compromises innovation for shareholder profits. A shareholder is much less likely to invest in new innovations that could potentially fail versus extracting profits from existing methods. In the long run example, future investment is much more profitable, but in the short term, deviation from accumulating financial assets to supporting future innovations will not yield short term profits. This is a potential reason why the total number of IPO's in the stock market has fallen in the past few decades by 40%.⁷⁵ Although the 40% reduction in IPO's over this period does not only consist of technology startups, the reduced innovation of public companies could be influencing this data.

2.19: Benefit of Small NFC's

The overall birth rates for small firms combined with the proportion of jobs in the economy that are created by small firms increase the need for their protection. Without the existence of small firms, jobs will not be consistently created and inequality will reach a devastating tipping point.⁷⁶ The tipping point can be avoided by a renewed focus in small firms for job growth and to fight inequality. Because of factors such as firm size and age that contribute to job growth, maintaining a substantial rate of small firm births is essential for economic stability and the full satisfaction of consumer demand.

⁷⁵ Foster, John Bellamy, and Fred Magdoff. 99.

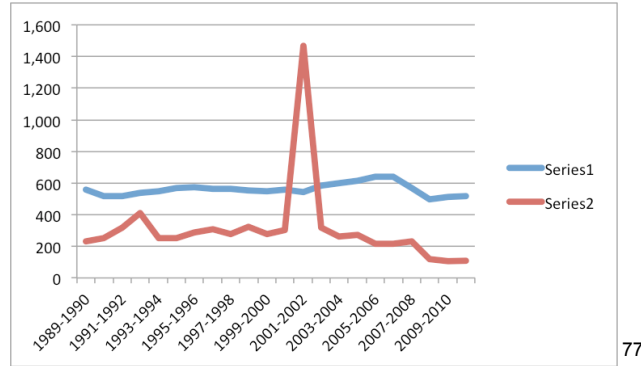
⁷⁶ Mandal, Arindam, and Mankirat Singh. 128.

Consumer demand is overlooked currently because of the emergence of superstores and large firms with over 500 employees that crowd out smaller firms in the market. Because of their willingness to take less profits, combined with a higher velocity of sales, small firms cannot compete for resources and are at an ultimate disadvantage. International competition has replaced swaths of small firms because of falling demand and output. The production of American goods has fallen over the previous century, although it is not necessarily due to the good being produced elsewhere. Investments need to be injected back into the economy in order to support the IS LM model with consistent job growth within multiple sectors. Savings and investment will not return to stable levels unless job creation is expanded into emerging sectors of the economy.

Chapter 3: Impact of Financialization on the Firm

3.1: Impact of Financialization on NFCs

The benefits of nonfinancial firms that are overlooked because of their tighter profit margins, although they are much safer and cost efficient for the overall economy. The smaller firms carry less risk for the economy during economic instability because they do not engage in risky behavior and financial activities that could have negative implications on the economy. Smaller firms do not engage in this behavior because their focus is concentrated in the business activities that will result in greater profits, as opposed to financial activities that would yield similar results. The unique characteristic of small firms to engage in strictly profit maximizing tendencies through the increased velocity of sales and business management has shifted because large firms are no longer innovating industries. The lack of technology that has emerged from the slowdown of non-financial firm births allows for maintained profits, but a stagnation in efficiency. The regulation during financialization has favored the increase of total large firms.



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Series 1 represents small firm births, while Series 2 represents large firm births

3.2: Perspectives Under Financialization

This stagnation can be seen in several factors of firm success and its overall ability to survive. The failure to innovate and make significant changes to efficiency in order to align with the preferences of the financiers will result in the extinction of non financial firms. The survival of these firms has been predicated upon their ability to adapt to the needs of the financiers, as opposed to running the most efficient and profitable business. Without the direction of management to pursue more efficient business practices, there has not been a movement to become more efficient and innovate. The financiers have not supported the widespread efficiency of firms and the concentration of production power has left the firm.⁷⁸ The production of firms has shifted significantly in the late 20th century because of financialization and competition outside of the United States. The internal support for American production firms has weakened because of the ability for financial corporations to acquire factors of production and lower prices. The shift in the factors of production and ability for corporations to

⁷⁷ SBA 2016. Graph Johnson. 2017.

⁷⁸ Orhangazi, Özgür. *Financialization and the US economy*. Cheltenham, UK: Edward Elgar, 2008. 56.

integrate these factors for their advantage has shifted business preferences throughout the economy.

3.3: Shift in Theory of the Firm

The shift in theory of the firm to support outside interests, has halted innovation at the firm level. Firms were able to survive because of their ability to generate profits and become more efficient, but not correspond with financial sector needs. The struggle for small firms to survive is paralleled with the lack of support for NFC's that have extended to impact legislation that supports the liberalization of risk taken by financiers. Resources are now committed to risky financial instruments that do not benefit the overall stability of the economy. The resources that were previously committed to firms in an economy with full employment were deviated elsewhere and objectives shifted to maximize financial wealth.⁷⁹ In order to achieve this the resources are devoted to financial channels and instruments to make them more efficient. The firms suffer and shift their behavior because of the lack of institutional support. The shift in institutional support for firms can be seen in the shift from "welfare capitalism" after WWII, to a corporate shift in the late 20th century that abandoned social constructs supporting small NFC's.⁸⁰ The threat of outside competition from other countries has contributed to this shift because of cheaper alternatives. The cheaper alternatives create greater profits for the financiers of capitalism, but it weakens the business relationship of firms within the American economy. It also contributes to the holes that have emerged in the

⁷⁹ Orhangazi. 143.

⁸⁰ Ibid., 181.

labor market because of the preferences of financiers to engage in business relations with countries that have lower wages.

3.4: International Influence on NFCs

The international competition that's emerged is a result of the financialization of the economy that has not supplemented marginal demand because it is only replacing current demand. Demand for goods produced by American firms is not improved by the decisions of the financiers because of the difficulty for American suppliers to generate profits. Firms within the American economy no longer act as complements to one another because of the influence and presence of international firms within the economy. The overall relationship between the principal and agent in agency theory, as Orhangazi notes, is disrupted because of the emergence of international threats.⁸¹ The relationship between the principal and agent in firms throughout the American economy are fading because new international business partners are favored. The former financiers of the NFCs in the economy have now deviated resources elsewhere. Although consumers may be rewarded with goods that are advertised as market basket goods for lower prices, the inability to offer these goods at the highest quality is creating economic instability.

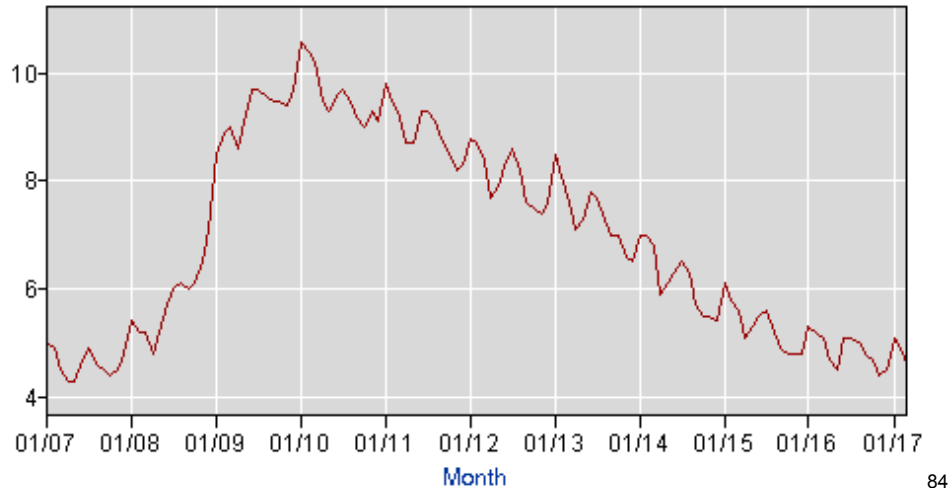
3.5: Firm Deviation Within Service Sector

⁸¹ Orhangazi. 64.

The lack of resources that are currently committed to the survival of small firms is only pushing financiers further towards international options. The international competition that has replaced domestic options for the production of goods, has negatively impacted other sectors such as the service industry that has lost approximately 50% of the total firms that existed in the sector seven years ago. (orghazi 81)⁸² Financialization has contributed to the decline of the production sector because of more profitable international markets, but the decline in the services sector is related to the crowding out of financial services through the reduction of small firms within the sector. The graph below represents the total number of service sector firms that existed in millions since 2007. The total number of firms within the service sector is composed of mainly small firms, as states had up to 99% of service sector firms existing as small firms.⁸³ The graph represents a falling industry and the falling value of the small non financial corporation. Later data in Chapter 4 on States' individual service sectors show that although the total firms in the service sector is falling, throughout the country financial services are rising. The shift in the service sector is representative of the effect of financialization decreasing the overall output of goods and services within the real economy.

⁸² Ibid., 81.

⁸³ SBA Report 2014. 126.



3.6: Resources of Firms

In the decades prior to financialization many monetary resources of the government and financial institutions were devoted to NFCs because they provided the most economic stability. Through self reinforcing effects within the economy, it was beneficial for these groups to promote entrepreneurship within firms for their own profitability. The resources aimed to improve technology, efficiency, and increase demand were further applied to larger firms within the United States or to international firms. The resources that are now committed to firms within the United States are not supporting NFCs. The resources are committed to raising internal profits through financial channels, as opposed to profit maximization through business efficiency and satisfying consumer demand. The business cycle has shifted as a result of this and dramatic changes have occurred for the firm and the consumer. The has shifted the structure of the firm to correlate with the increased influence of Corporate America.

⁸⁴ Bureau of Labor Statistics. Graph Johnson 2017.

These factors include “the factors of distribution, consumption, investment, and growth”⁸⁵ within individual firms. Consumers, firms, and the financial institutions are minimally linked in this business cycle because of the false benefits economic agents are receiving. Although some sectors of the economy may be thriving, the underlying causes of success are weakening other areas of the economy. The ability for production to survive and thrive for American firms is threatened because of financiers unwillingness to support it.

3.6: Firm Production

The overall shift from production to finance has been a primary influence of the recent recession. The continually growing financial sector is an issue within itself because of overwhelming support that the sector has received in terms of bailouts and monetary support for investors. The crowding out that has occurred because of the substantial financial sector is a primary reason why despite a falling rate of unemployment, jobs are not being returned to specific sectors. Along with the specific production sectors that have suffered because financialization, the small firms that range across sectors are being diminished equivalently. Although small firms are the primary driver of job creation, they are no longer favored over larger firms with lower production costs. The larger firms can easily out price smaller firms selling market basket goods because of the lesser profit margins needed.⁸⁶ The small firms are

⁸⁵ Whelan, Karl. "Unemployment and the Durational Structure of Exit Rates." *SSRN Electronic Journal*. doi:10.2139/ssrn.94209. 277.

⁸⁶ Haiven, M. "Walmart, Financialization, and the Cultural Politics of Securitization." *Cultural Politics and International Journal* 9, no. 3 (2013): 239-62. doi:10.1215/17432197-2346964.

sometimes more convenient to the consumer because of the locational availabilities and total number of small firms that exist in the United States. Without the influence and available number of small firms in the market, jobs will be lost and prices for consumer goods will climb.

3.7: Firm Competition

The number of small firms that exist throughout the country provide the needed competition that force larger firms to reduce prices because of their smaller profit margin. If the larger firms did not have the competition of the smaller firms then their prices would be higher. If large firms were able to charge the same price as the small firm, they would increase their profit margin and eliminate small firms from the market. Despite the convenience and the benefits of the small firms throughout the country, in the current economic environment they are not supported for continuous growth. The growing presence of the financial sector has only created more favor for the larger firms that can readily engage in financial activity. Without the ability to engage in financial activities, the financial sector has no reason to support small firms in the growth and stability of them because they can not create financial channels.

3.8: Firm Behavior and Influence

The ability and need to create financial channels in business puts the primary focus on profit and ignores economic environments and current stability. Although the development of finance has become overarching for the economy, the entire country is

affected by it, but there is a continued support of financial institutions. The support that financial institutions have received in recent years only protect their interests further and allude to an overall fall of the NFC. The NFC will not be able to survive in the current economic atmosphere because the financial institutions will continue to favor larger firms. The current rates of firm births and deaths indicate that larger firms will become more frequent to replace the large number of small firms that have become extinct. The labor market and income inequality will be critical if current trends continue that create more firm births than deaths. More jobs may become available for larger firms, but wages may become lower for profit maximization. (walmart) This would lead to an increase in inequality because of the widening gap between the owners of large firms and the numerous employees. Small firms are ultimately favorable compared to large firms because of their ability to positively promote firm births, labor market growth, competitive wages, and suppress inequality.

3.9: Impact on Relation Banking

Relation banking is essential to the development and continued funding of small firms. The trend of financialization has weakened the funding of new firms in the economy so the need for relation banking is essential in order to fund the creation of these firms. The largest banks are committing more loans to small businesses, but the fall in funding for all other banks is negative. It supports the notion that financialization is only strengthening the largest banks, as opposed to the entire financial sector. The

pattern of lending deviates from small firms because total assets towards small firm creation is falling according to these tables. The larger banks grant smaller loans and contribute fewer total assets to small business.

Wells Fargo Bank, National Association	1,554	\$458,930,900	\$295,322
Live Oak Banking Company	281	\$362,614,300	\$1,290,442
The Huntington National Bank	837	\$163,840,500	\$195,747
JPMorgan Chase Bank, National Association	735	\$149,339,900	\$203,184
Celtic Bank Corporation	360	\$139,972,100	\$388,811
U.S. Bank National Association	489	\$132,923,500	\$271,827
Newtek Small Business Finance, Inc.	112	\$96,090,500	\$857,951
Byline Bank	75	\$79,743,000	\$1,063,240
Pacific Premier Bank	46	\$70,585,400	\$1,534,465
KeyBank National Association	142	\$65,171,800	\$458,956
Bank of the West	81	\$61,389,000	\$757,889
First Home Bank	216	\$60,224,200	\$278,816
Seacoast Commerce Bank	52	\$58,218,600	\$1,119,588
Synovus Bank	37	\$57,813,000	\$1,562,514
SunTrust Bank	103	\$55,925,800	\$542,969
Bank of Hope	85	\$55,263,000	\$650,153
Commonwealth Business Bank	42	\$55,169,000	\$1,313,548
Stearns Bank National Association	177	\$55,094,500	\$311,268
Compass Bank	341	\$54,135,600	\$158,755
Manufacturers and Traders Trust Company	360	\$53,915,900	\$149,766

Table F. Number of Small Business Loans Outstanding by Lender Size, 2008-2013
(millions of loans)

Loan Type and Size	2008	2009	2010	2011	2012	2013	Change 2012 - 2013	
							Difference	%
Lenders by Total Asset Size								
Less than \$100 million	0.41	0.41	0.31	0.28	0.24	0.20	-0.04	-14.8
\$100 million to \$499.9 million	1.41	1.38	1.23	1.09	1.04	1.00	-0.04	-4.0
\$500 million to \$999.9 million	1.83	1.85	1.94	1.69	1.58	1.50	-0.08	-5.2
\$1 billion to \$9.9 billion	5.17	1.22	1.14	1.34	1.42	1.38	-0.04	-2.5
\$10 billion to \$49.9 billion	3.46	3.19	1.56	1.52	1.57	1.72	0.15	9.9
\$50 billion or more	14.95	15.13	16.21	15.41	17.69	17.17	-0.52	-3.0
Total Small Business Loans	27.23	23.18	22.39	21.33	23.54	22.94	-0.56	-2.4

Source: Federal Deposit Insurance Corporation, Statistics on Depository Institutions, June 2008 through June 2013.

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3.10: Small Financial Firm Behavior

The widespread impact of financialization changes all levels of industry because of the growing influence of the large financial corporations. Although the largest financial corporations are now responsible for the majority of small business loans, the fraction of their assets that they devote to small business contributes to the weakening of the small firm. The small firms are compensated with fewer loans because the corporate giants have taken the market share from the small banks and lenders. The small banks were much more committed to the direct financing of small firms averaging 400% more of their total assets that went towards small business loans from the data on small business lenders.

⁸⁷ SBA. 2015.

⁸⁸ SBA. 2014.

Chapter 4: Case Study of Financialization Depleting Number of Small Firms

4.1: Introduction of Research

The analysis of Financialization shows its negative effect on small firms, the production of goods and services, and the jobs within the sectors. The number of small firms within these sectors and in the real economy represent weak industries and decreased employment because of the increased reliance on large firms. The trend of falling total firms within specific industries represents a growing problem with financialization that is seen throughout the country. The rate of small firm births and deaths compared with large firm births and deaths indicate that the country is not retaining small firms. The small firms are dying much faster than the large firms and it is seen across multiple sectors. Financialization has negatively affected parts of the

financial sector because small firms within the sector cannot survive with corporate competition. The relation lending that once dominated the funding of small firms has vanished for much of the country and it is represented in the total number of small firms. Financialization has changed the number of small firms within each sector and created a correlation between the falling production sectors and the unstable financial sector.

4.2: Research Approach

The research begins with the general idea that large firm births are proportionally exceeding the births of small firms over the same period of time. This trend indicates the favoritism of financiers towards the continued creation of large firms and away from the funding of small firms. The national total of small firms has decreased, but the financial sector continues to grow. The growth of the financial sector is mainly due to the growth of corporations in the period of financialization after the 1980's and specifically the last two decades. Financialization's reduced the number of firms and jobs within these sectors on a national level, but individual states have sustained growth. The deviation between the national decline of small firms and the sustained growth of firms within specific states indicate that financialization will not be supported with unilateral growth. The national data represents a growing financial sector and declining production sectors. This will not be supported in the long-run because the financiers will no longer fund the production of real goods and services. The shadow economy that is developing can be seen in the decline in output and production of goods and services.

The economy will worsen because the shadow banks that contributed to the previous crisis will continue to grow, while putting the economy at a greater risk for a depression. In order to avoid this economic disaster there needs to be an increased importance placed on production and the growth of jobs within the sector. Although jobs that have been lost to overseas competition will likely not return, increased investment and the financial support of these sectors is necessary for the success of the economy. The data shows that small firms are dying more prevalently and opening in fewer numbers mainly because small firms are crowded out and funded with less money.

Prior to financialization, relation banking and large corporations committed a greater percent of total assets to the creation of small firms. The fall in assets committed by the financial industry towards the creation of small firms by all types of banks has weakened the industry on a national level. States that have committed more financial assets towards these industries will have stable financial sectors because of the existence of a stronger real economy. This is explained by the necessity for small firms within the economy as an equilibrium between producers and lenders supports stable growth. The financial sector cannot supplement lost output so on the state and national level the economy needs to reach an equilibrium within these sectors to generate stronger employment.

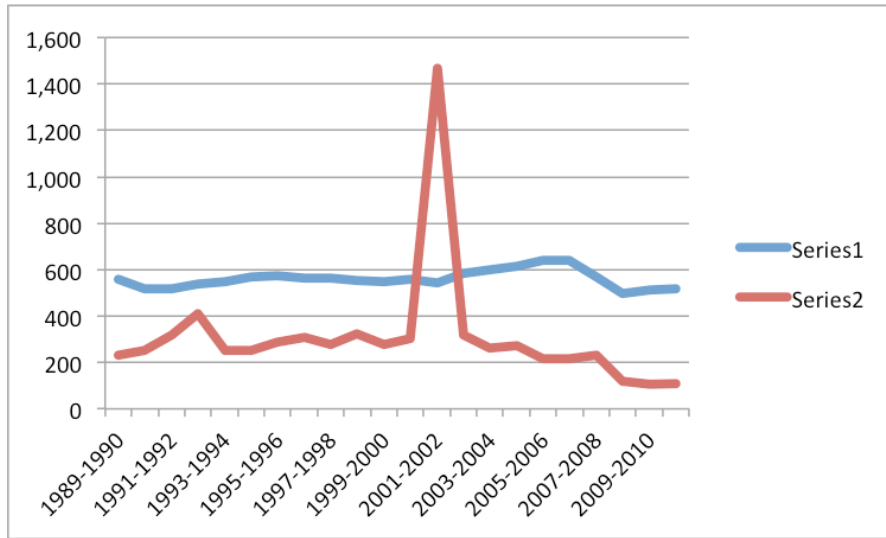
4.3: Correlation of State Data on Firm Sizes

The macroeconomic dilemma of financialization affects microeconomic firm behavior throughout the country because of the decreasing ratio of firm births to deaths.

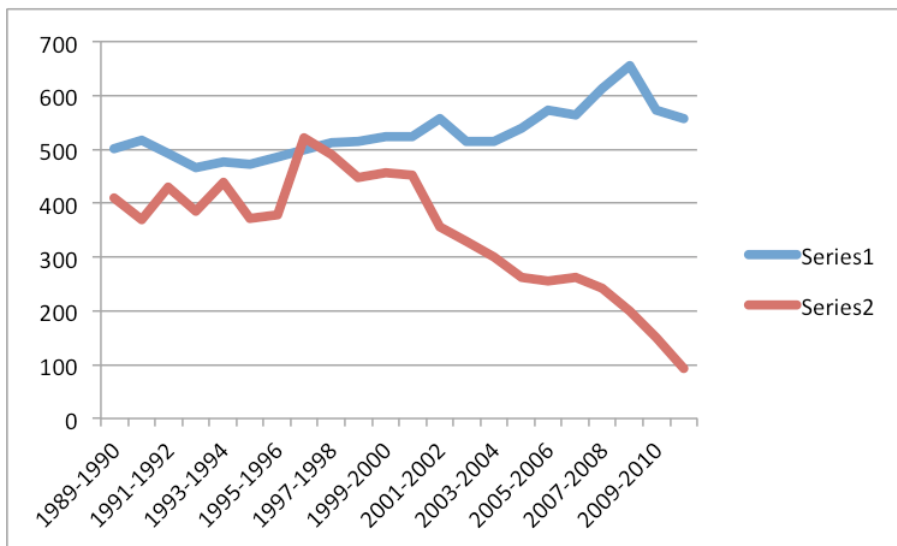
The small firms are representative of the majority of total firms in the economy and their success correlates with the stability of firm growth. When small firms within a state or national economy are failing it indicates unstable growth because of the emergence of shadow economies. The deaths of small firms indicate that corporations are crowding out the small firms in the national economy and only on the state level industries have grown simultaneously. The growth of small firms in the production and financial industry support the stability of both sectors on a state level. The growth of both industries on the state level indicates that the fall in output and production in the United States could improve with the national support for small firms.

The deviation of firm growth from the national level to the state level shows growing financialization nationally while many states continue to ignore the survival of small firms. The national data on firm births and deaths show small firms falling with decreased regulation following the crisis. The data then contains a specific case study on the largest and fastest growing economies from each region in the years before and after the recession. The trend of financialization that is seen nationally is compared with the trend of firm births and deaths for these specific states, as an indicator of the “strongest” economies within the country. The fastest growing and strongest economies should indicate stability with firm and job creation. The data from the aggregate state indicators of strong firm growth is followed by the individual state data of the specific sectors affected by financialization. Each state had four groups of data analyzed broken down by manufacturing employment, total number of manufacturing firms, total number of goods producing firms, and total number of financial firms.

4.4: National Data



Small firm births in Series 1 are compared with large firm births in Series 2.



Small firm deaths in Series 1 are compared with large firm deaths in Series 2.⁸⁹

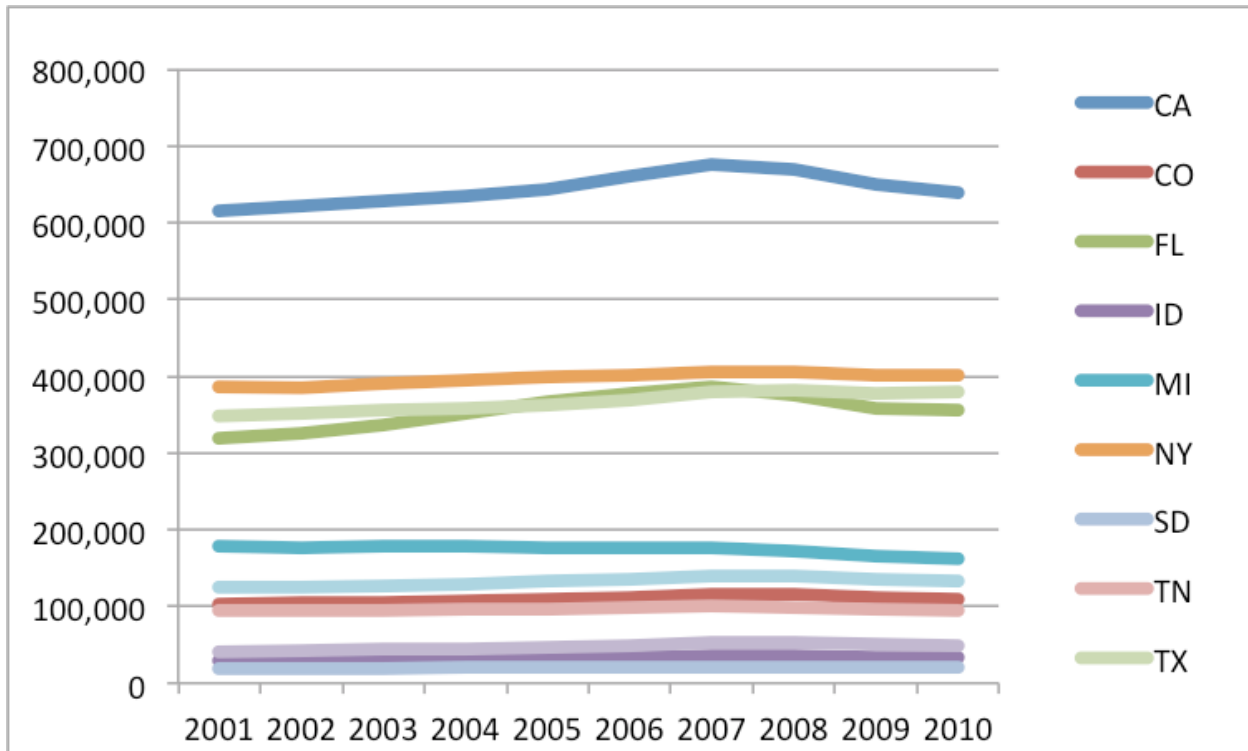
4.5 Case Study of Growing State Data

2001 2002 2003 2004 2005 2006 2007 2008 2009 2010

⁸⁹ SBA 2014. Graph Johnson. 2017.

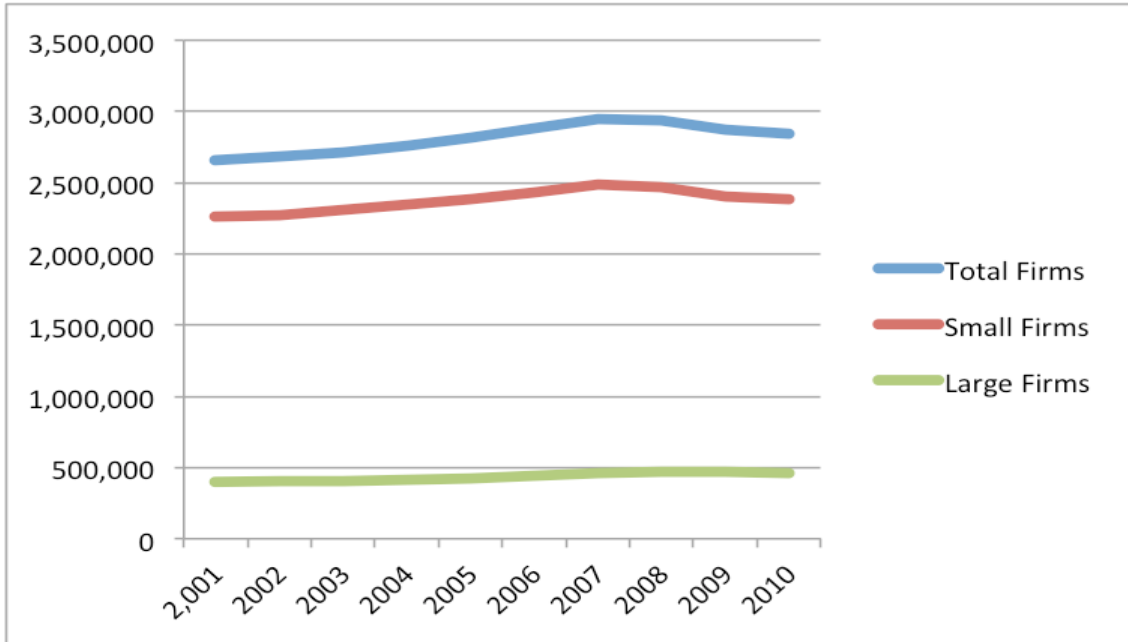
CA	615,310	620,665	628,269	634,646	643,667	659,781	674,670	669,432	650,246	639,416
CO	102,960	104,090	105,772	107,400	109,624	112,360	115,359	115,369	112,060	110,229
FL	318,407	325,283	335,778	351,471	365,591	377,616	386,454	375,447	358,637	356,458
ID	28,687	29,239	30,111	31,194	32,550	34,604	36,558	35,811	33,816	33,104
MI	179,509	177,382	177,510	177,641	177,173	176,244	175,974	171,791	165,494	162,162
NY	385,723	384,881	389,811	394,506	398,632	401,528	405,103	406,142	400,713	401,767
SD	19,086	19,373	19,495	19,819	20,030	20,191	20,654	20,587	20,360	20,465
TN	94,824	95,048	95,288	96,423	96,810	97,685	100,411	99,520	96,495	94,972
TX	348,094	351,921	355,297	358,828	362,240	367,884	378,891	381,170	378,188	379,063
UT	40,895	41,904	43,476	44,971	46,766	49,432	52,905	52,991	50,598	49,925
WA	125,303	125,087	126,776	129,019	132,098	135,715	140,113	140,270	134,591	132,876

State data of total small firms in fastest growing economies.⁹⁰

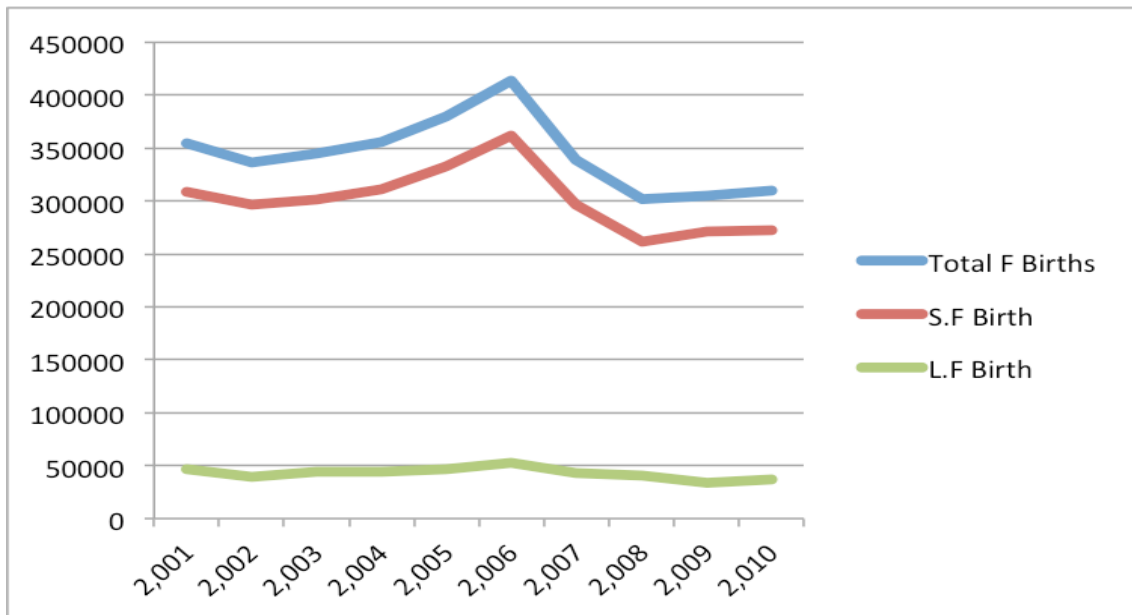


Total number of small firms in selected states.

⁹⁰ SBA 2015.



Total firms within selected states compared with number of small and large firms.⁹¹



Total firm births represented by small and large firm births.

⁹¹ SBA. 2014. Graph Johnson. 2017.



Total firm deaths represented by small and large firm deaths.⁹²

4.6: Individual State Data Explained

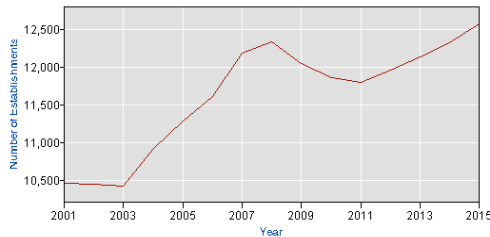
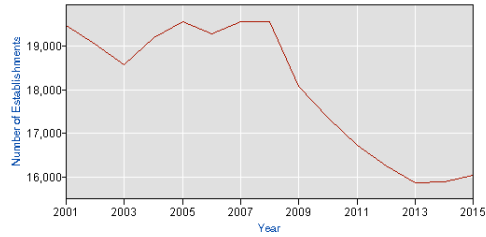
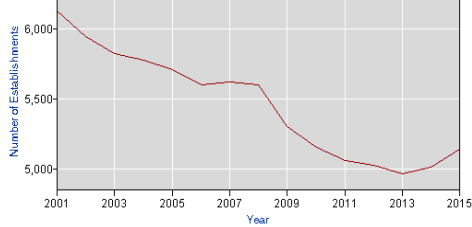
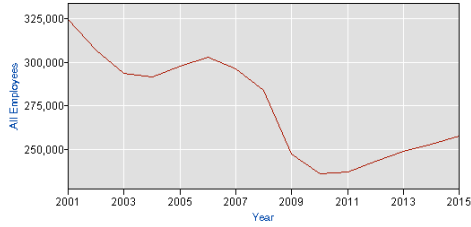
All states are represented and arranged in alphabetical order with 4 graphs representing the manufacturing employment (top left), number of manufacturing firms (top right), number of firms producing goods (bottom left), and number of financial firms (bottom right). Each graph is representative of the specific sector as it corresponds with the data in each state over the past fifteen years. All graphs in the next section correspond with data from the U.S. Bureau of Labor Statistics.⁹³

⁹² SBA. 2014. Graph Johnson. 2017.

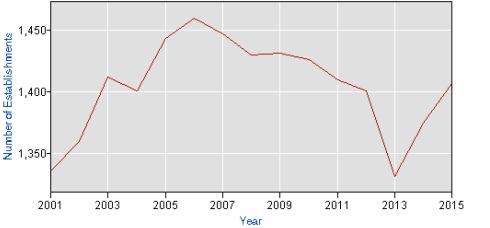
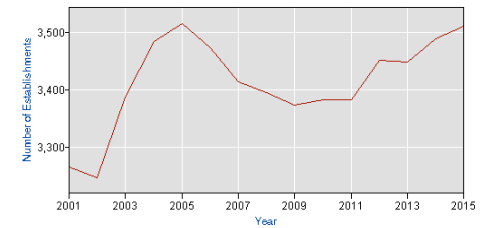
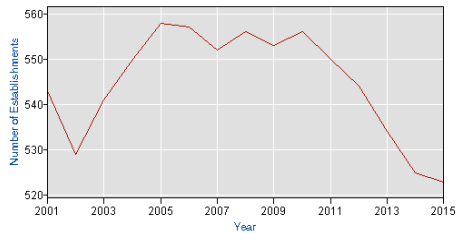
⁹³ U.S. Bureau of Labor Statistics. 2016. Graphs Johnson. 2017.

4.7: Individual State Data

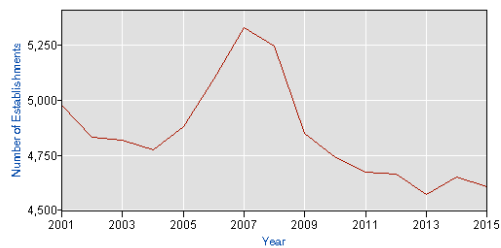
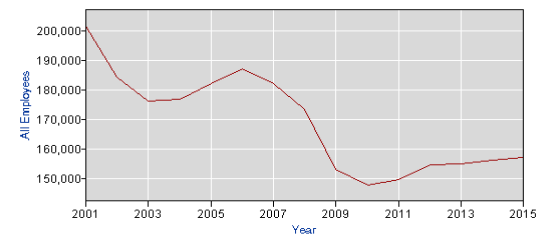
Alabama

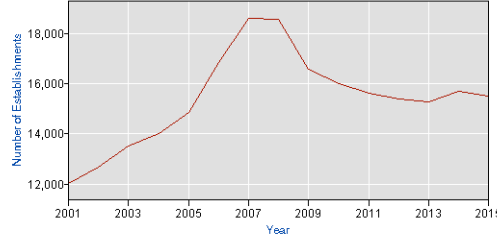
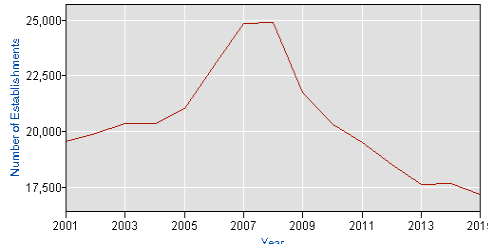


Alaska

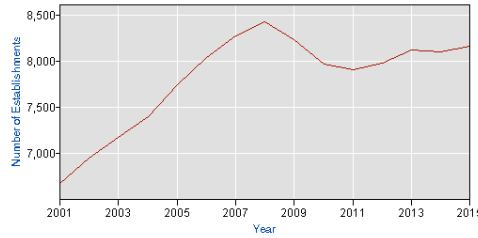
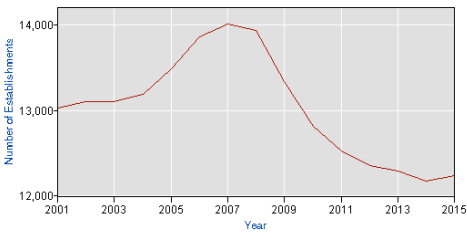
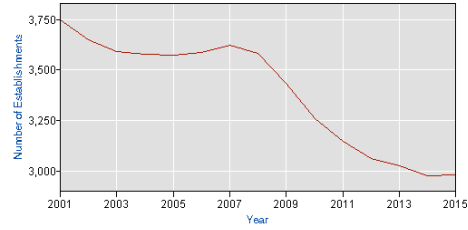
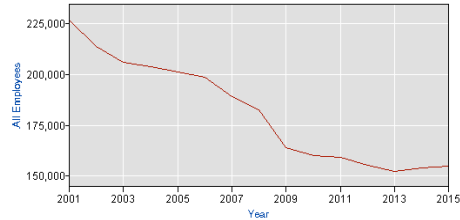


Arizona

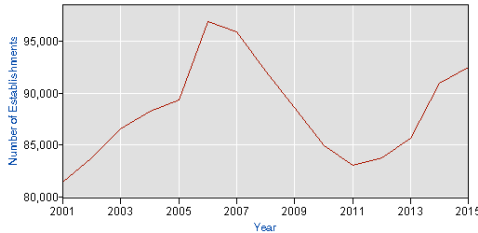
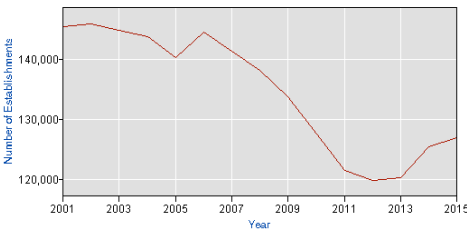
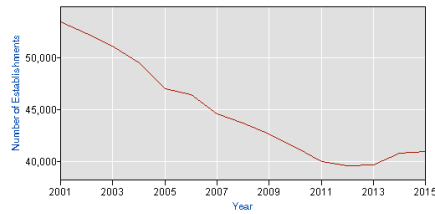
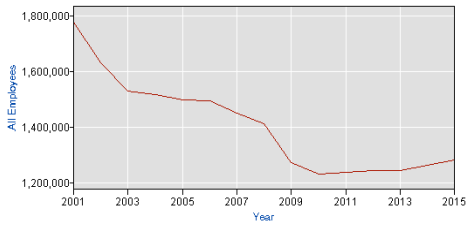




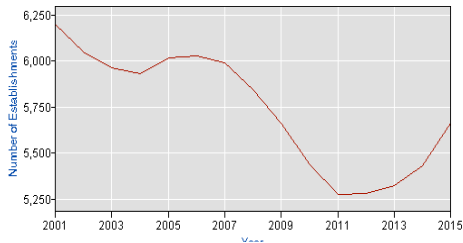
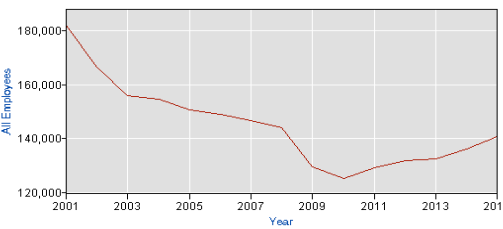
Arkansas

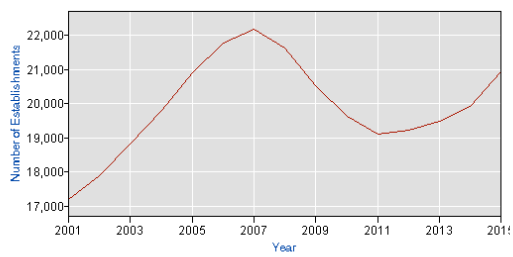
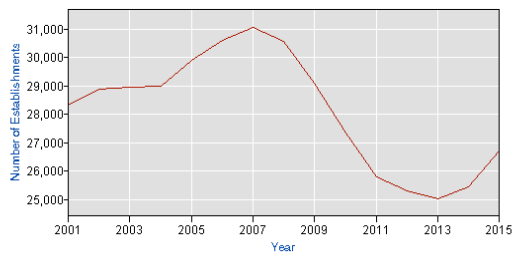


California

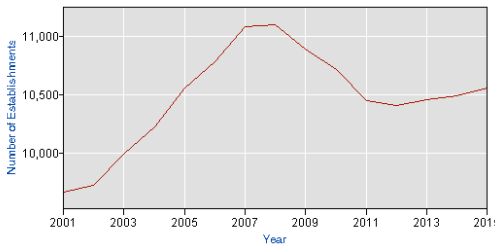
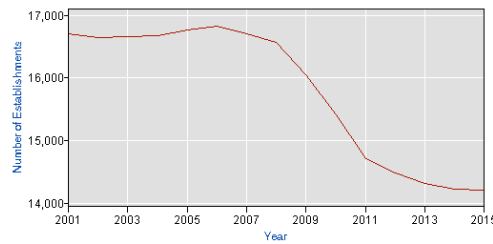
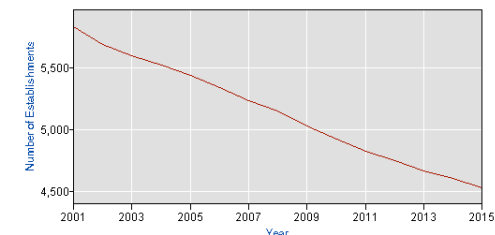
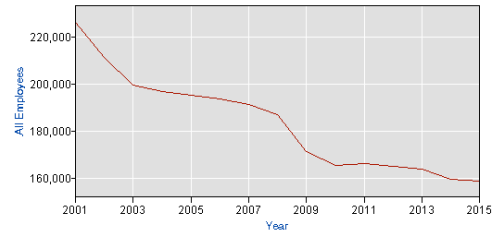


Colorado

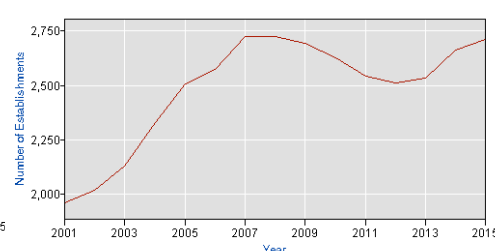
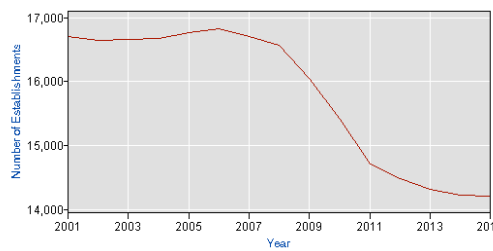
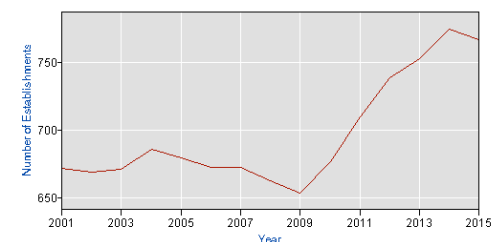
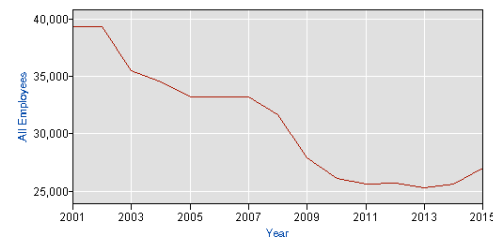




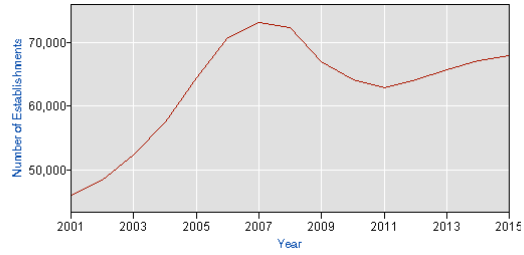
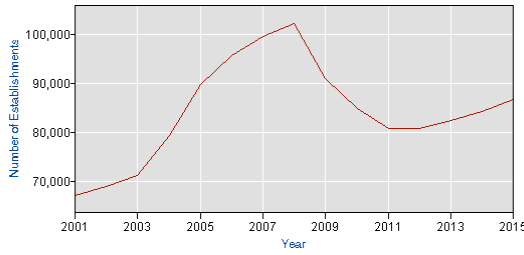
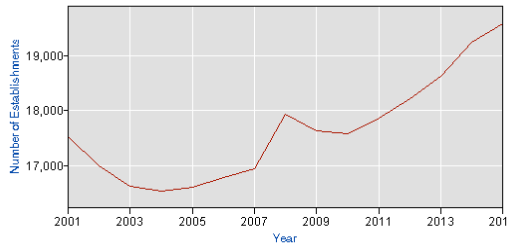
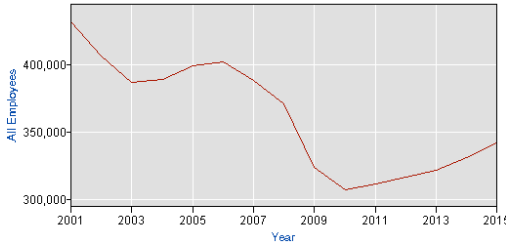
Connecticut



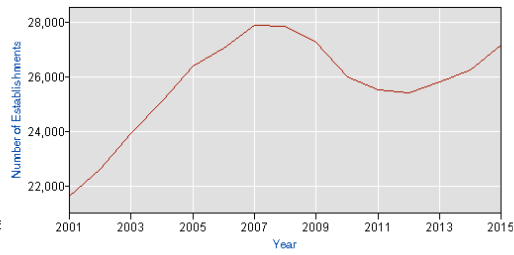
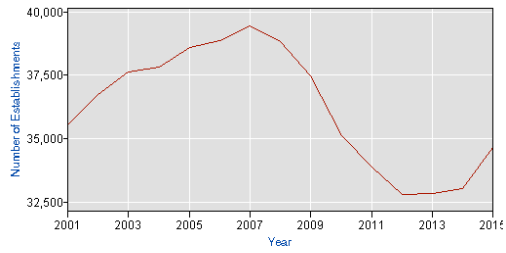
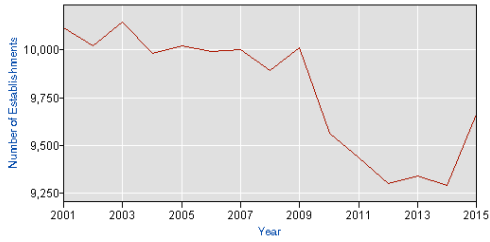
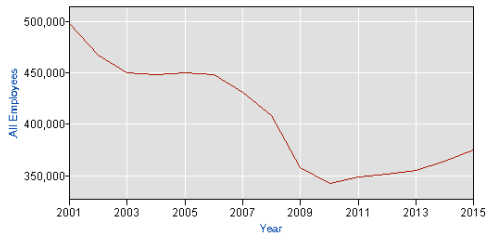
Delaware



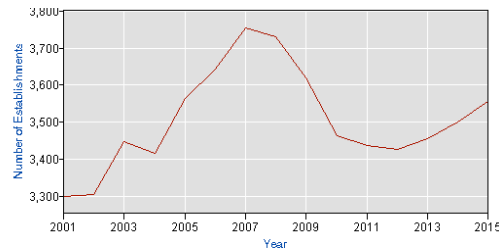
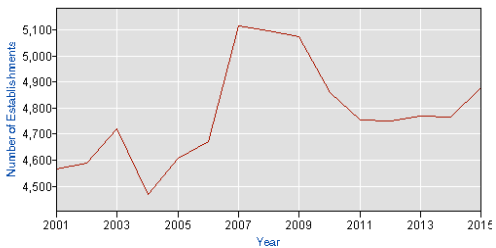
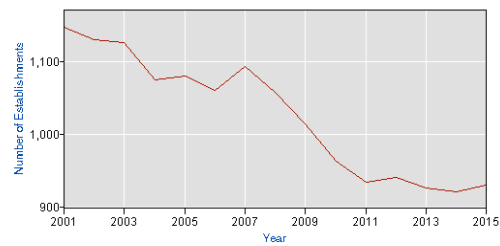
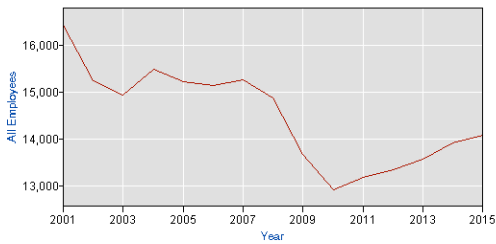
Florida



Georgia



Hawaii



Idaho



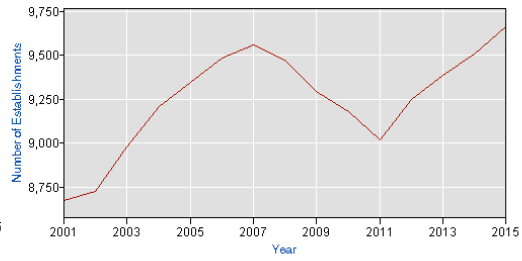
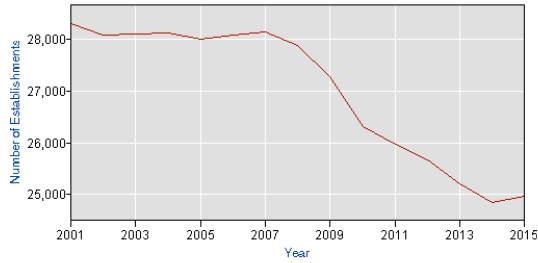
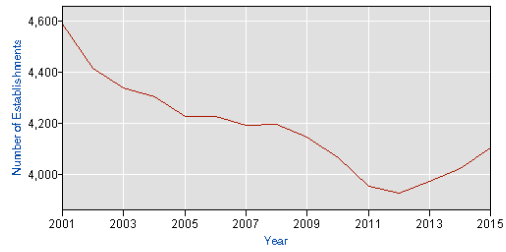
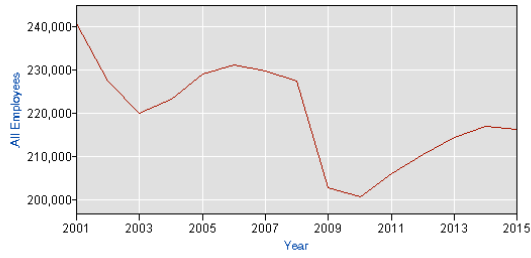
Illinois



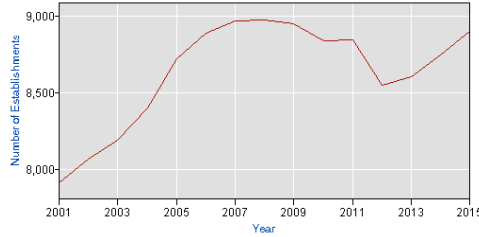
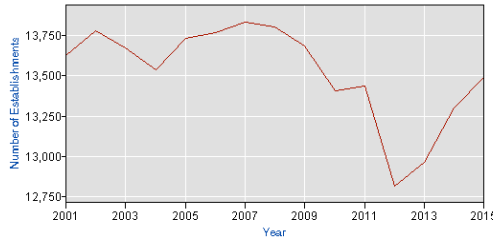
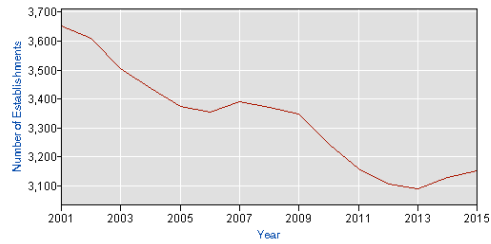
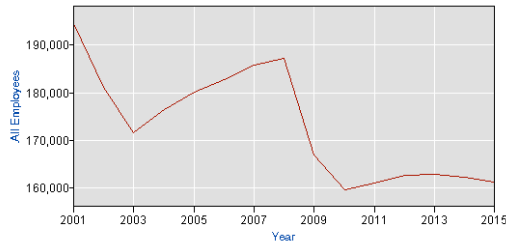
Indiana



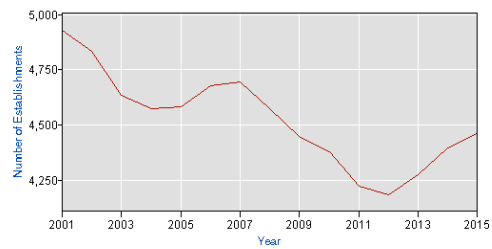
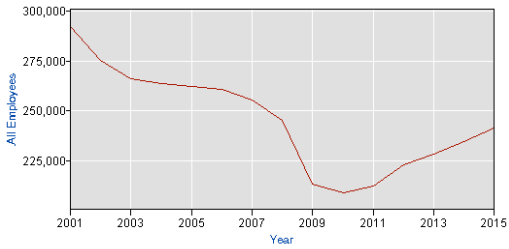
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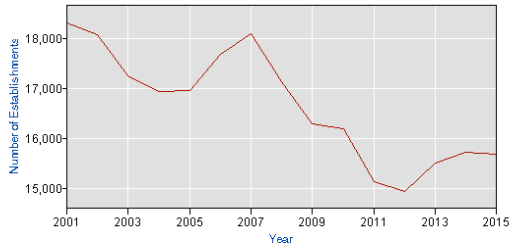


Kansas

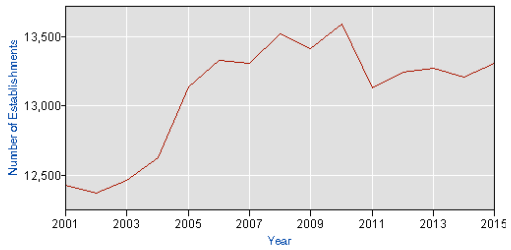
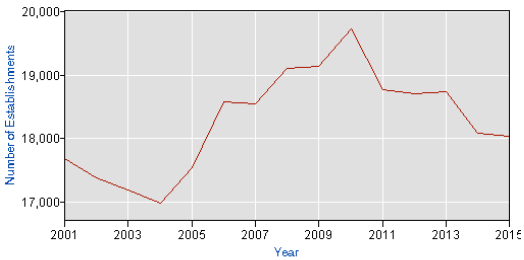
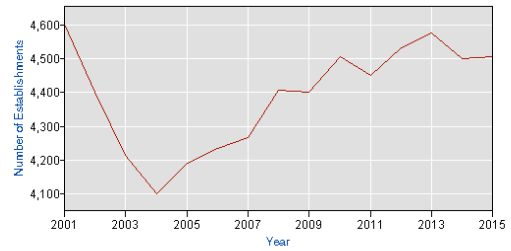
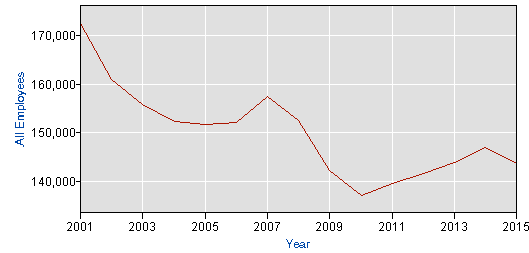


Kentucky

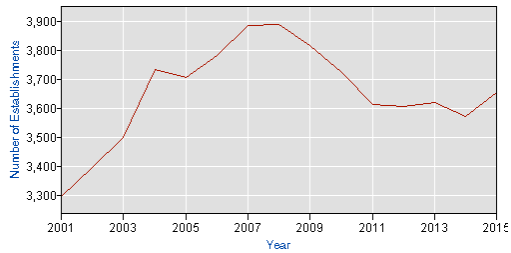
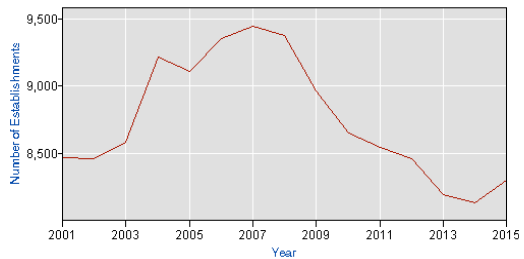
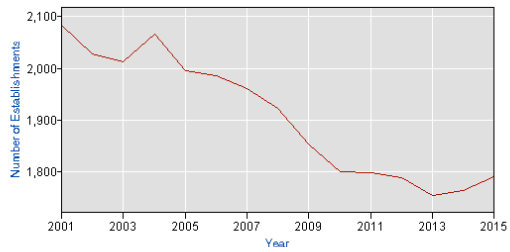
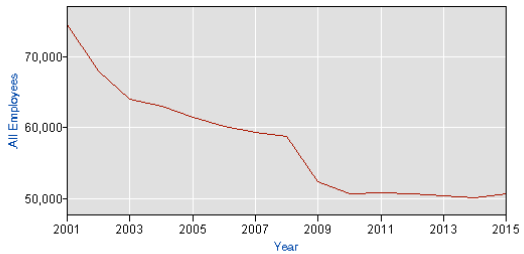




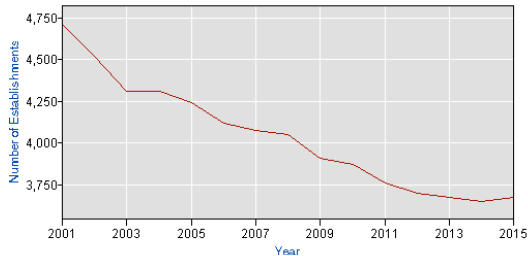
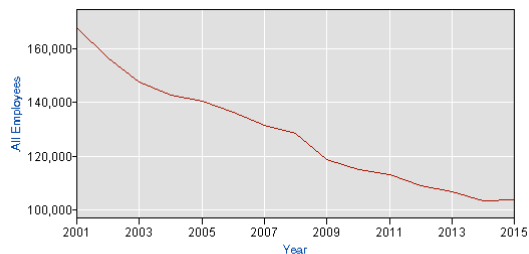
Louisiana

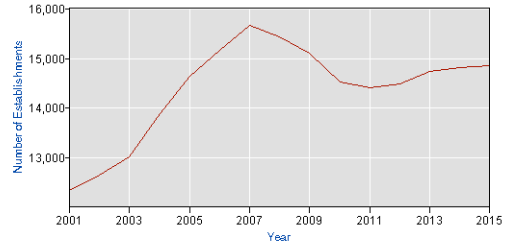


Maine

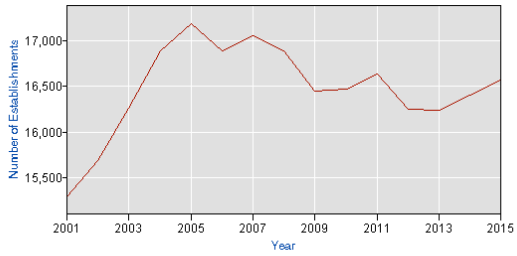
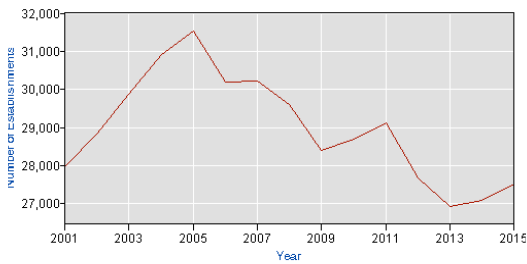
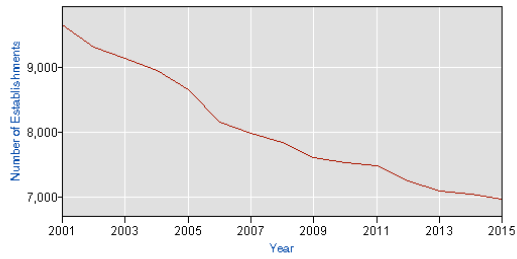
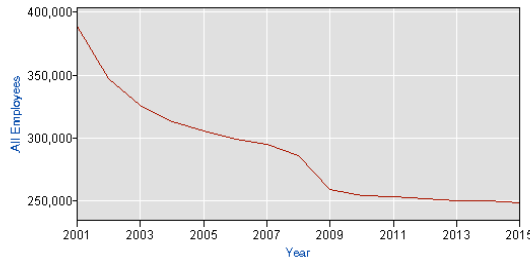


Maryland

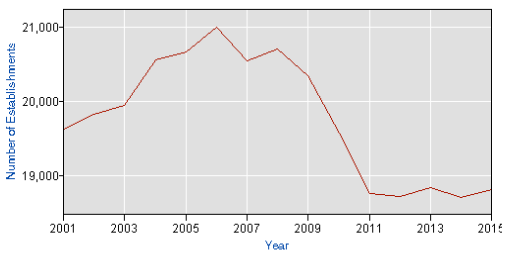
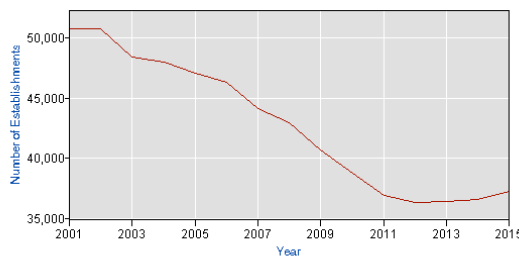
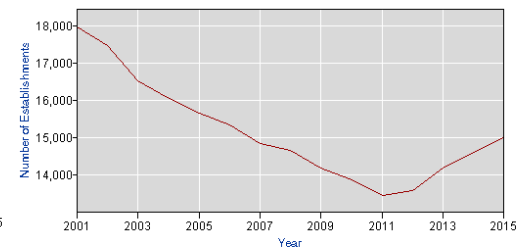
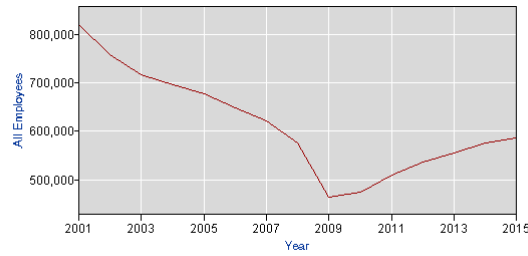




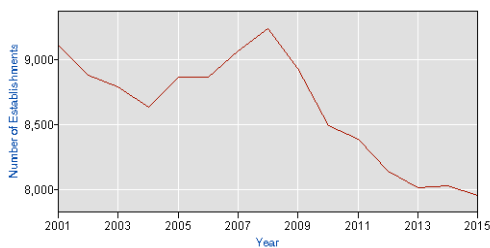
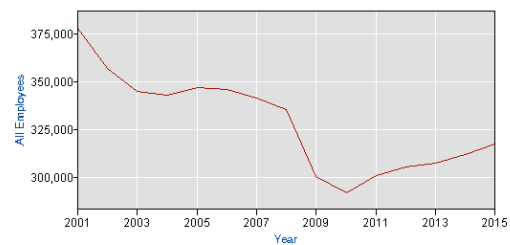
Massachusetts

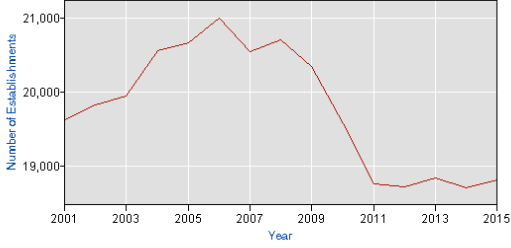
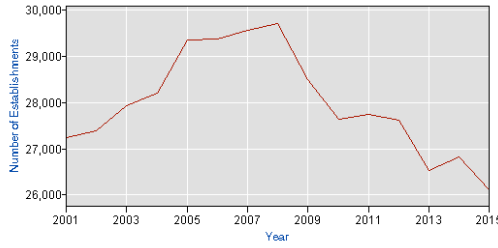


Michigan

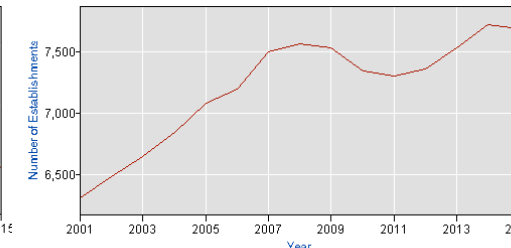
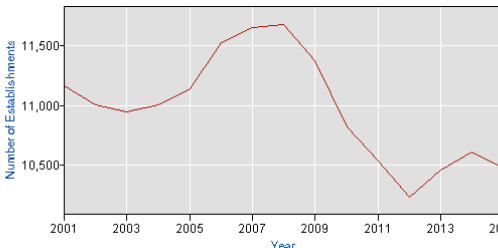
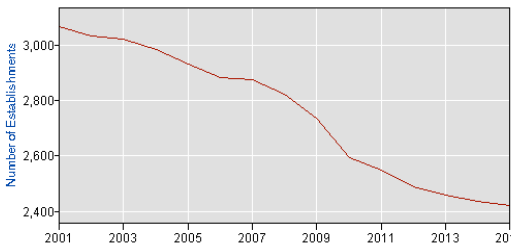
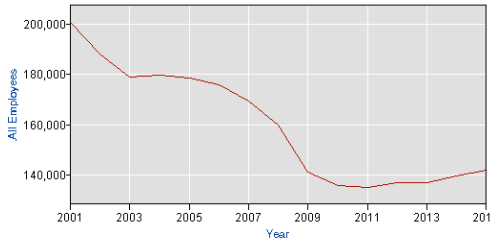


Minnesota

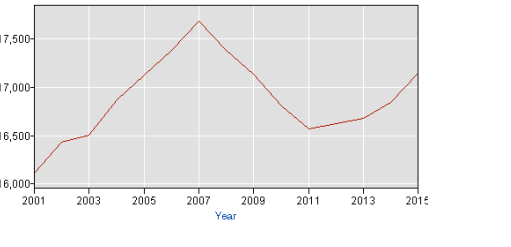
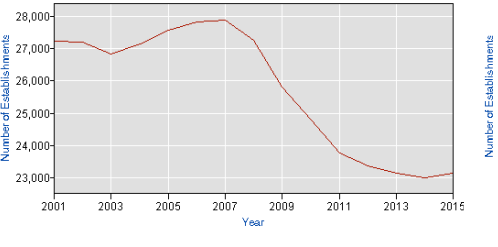
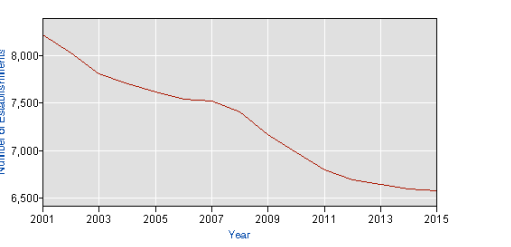
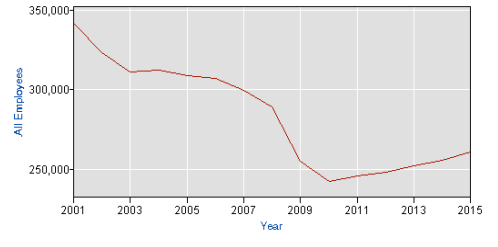




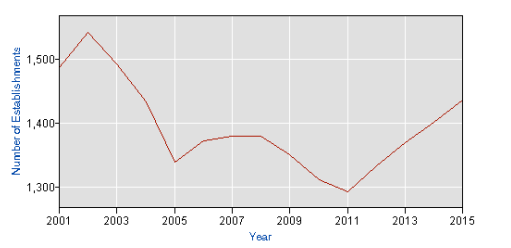
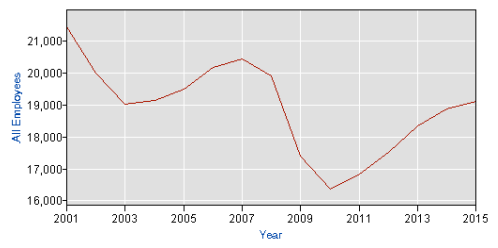
Mississippi

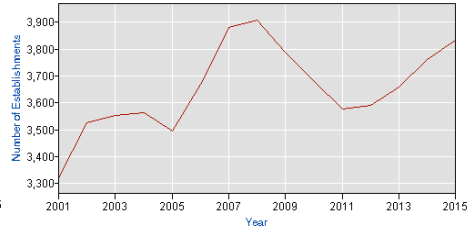
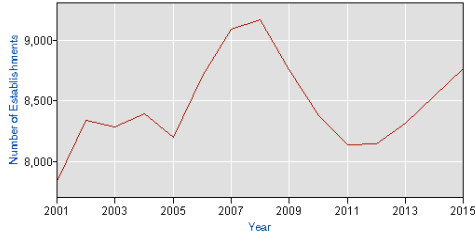


Missouri

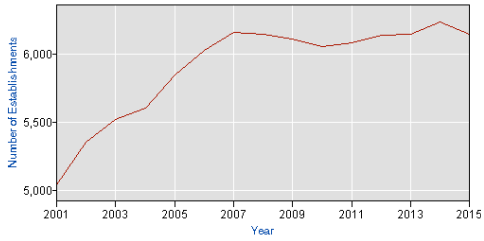
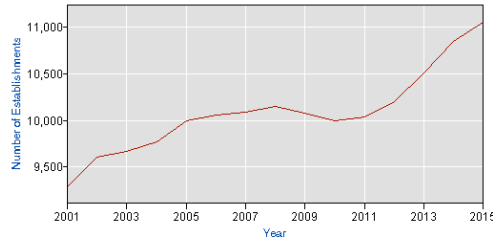
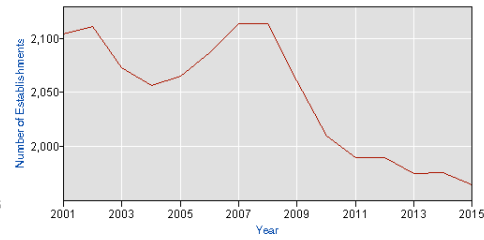
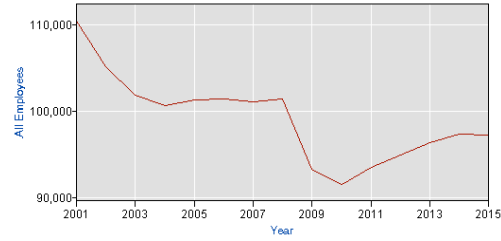


Montana

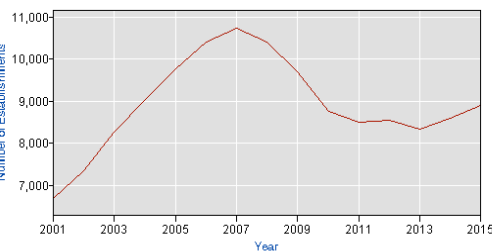
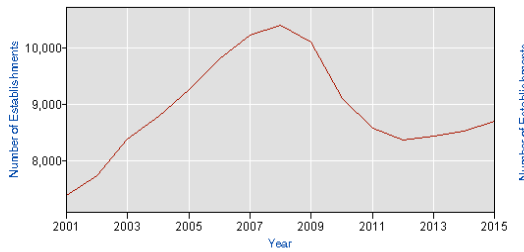
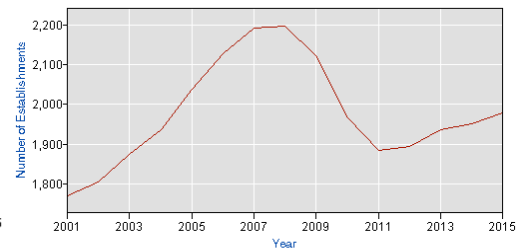
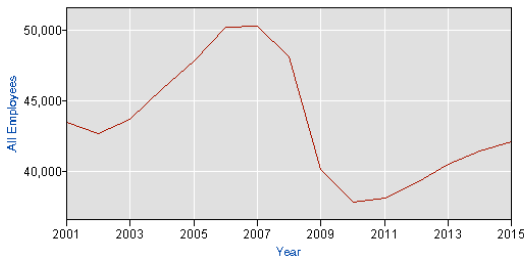




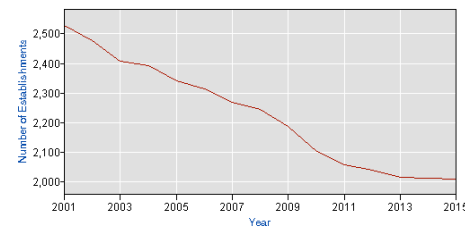
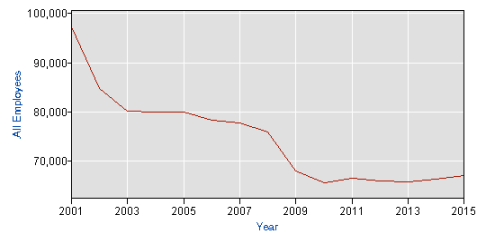
Nebraska

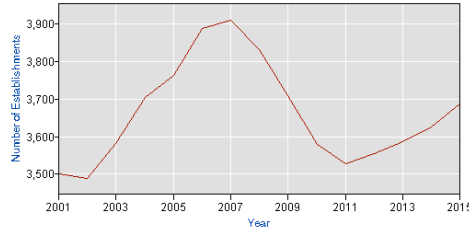
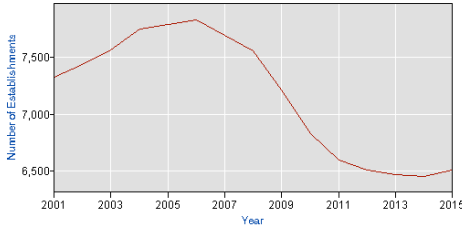


Nevada

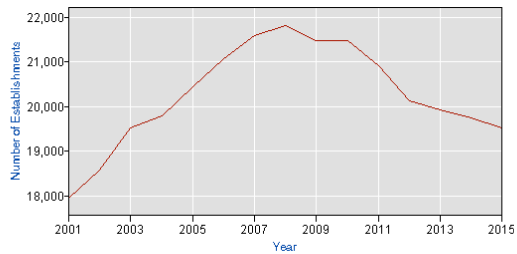
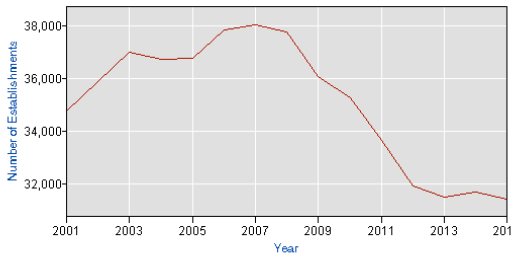
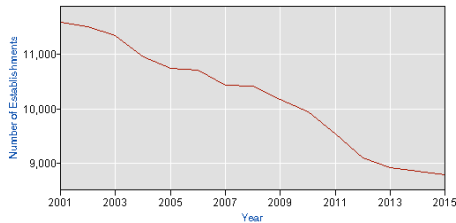
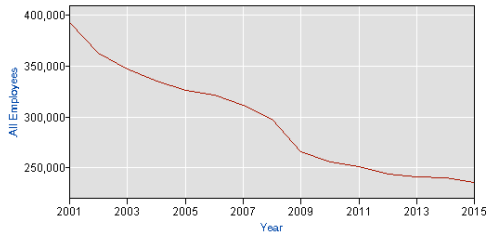


New Hampshire

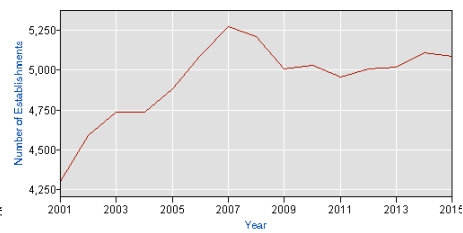
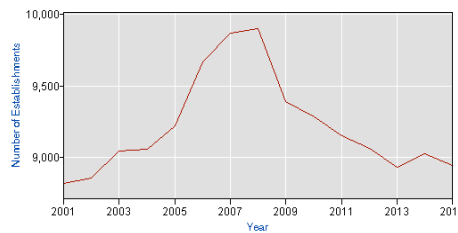
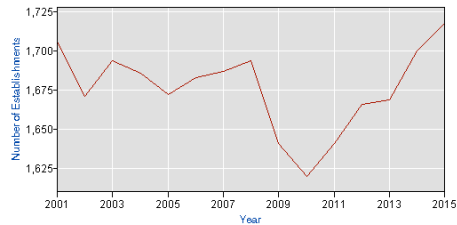
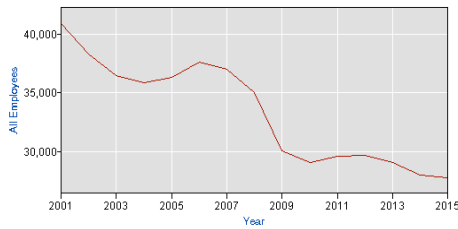




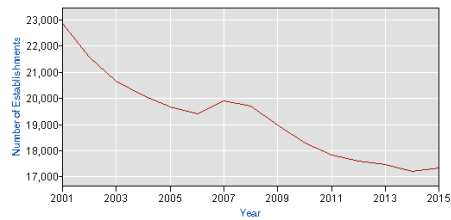
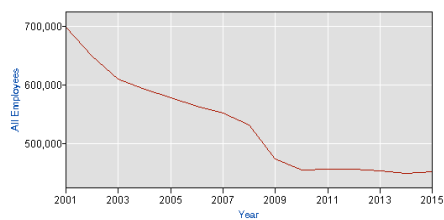
New Jersey

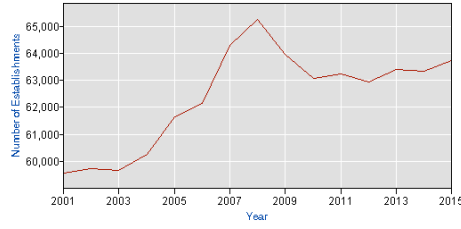
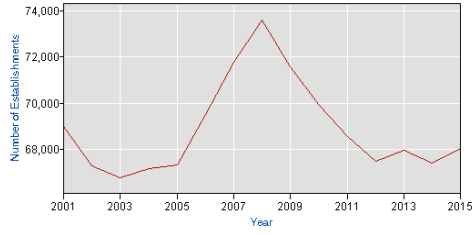


New Mexico

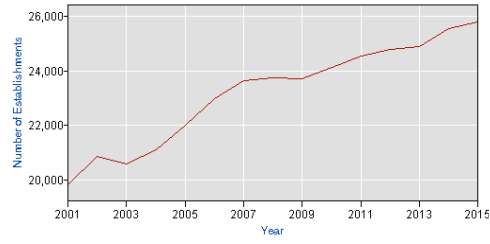
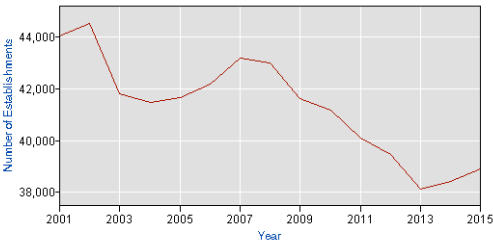
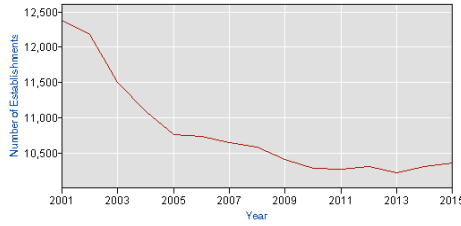
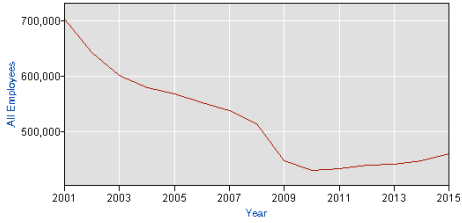


New York

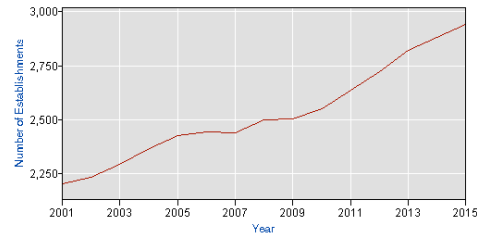
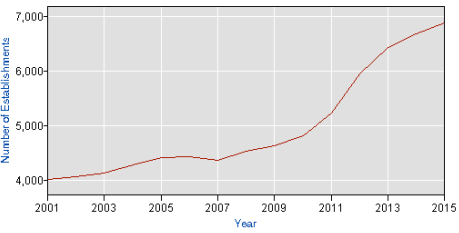
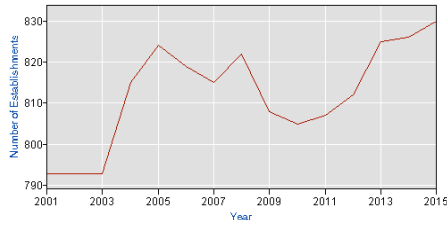
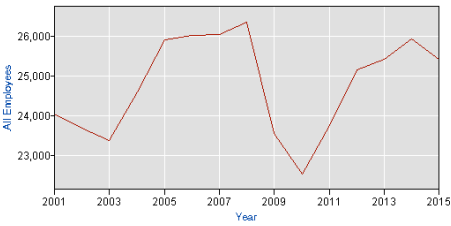




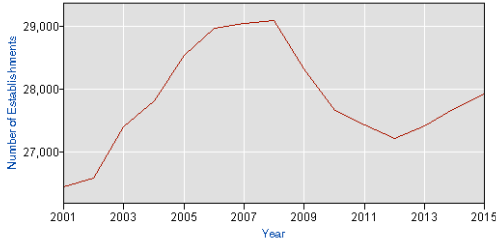
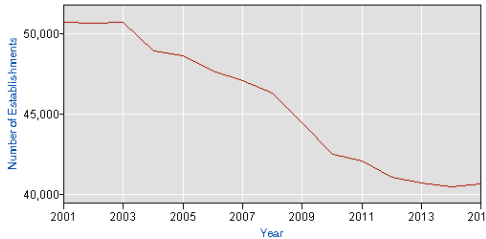
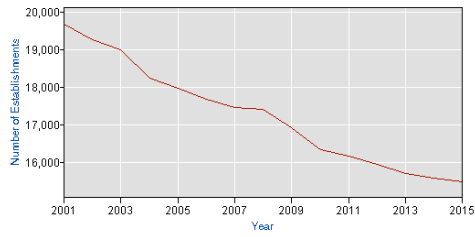
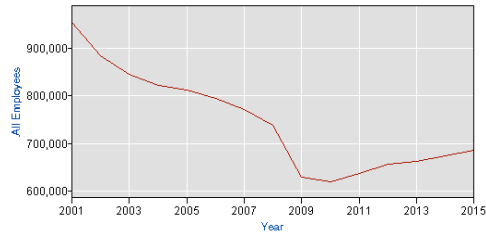
North Carolina



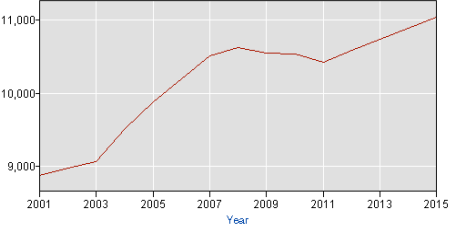
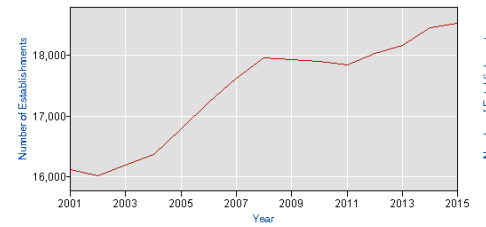
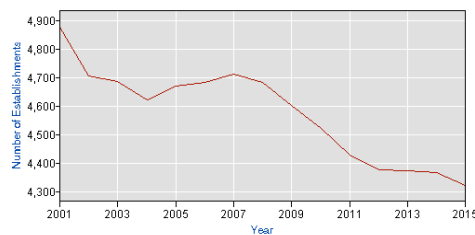
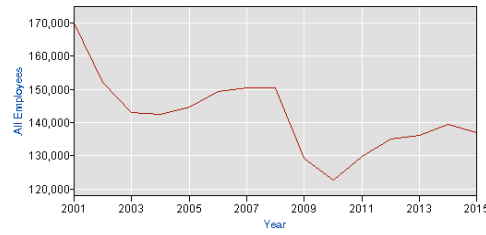
North Dakota



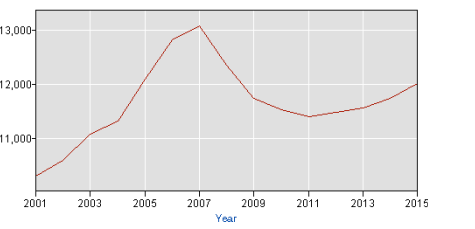
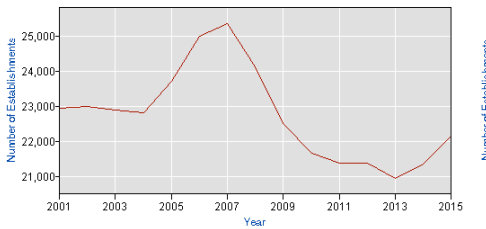
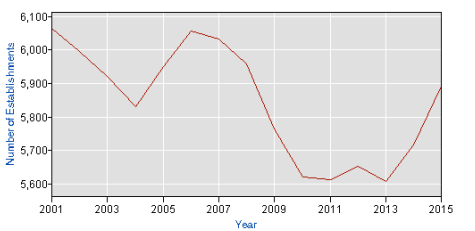
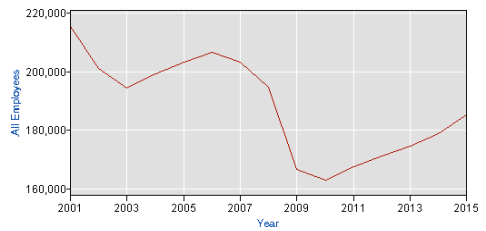
Ohio



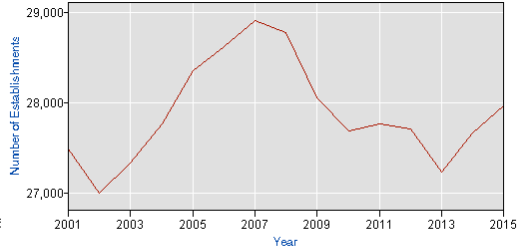
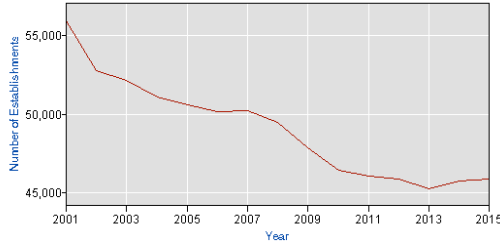
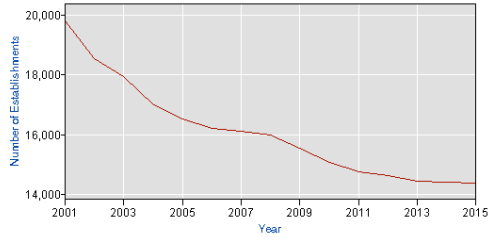
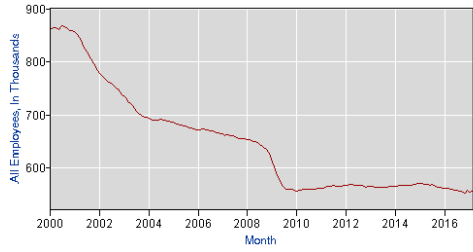
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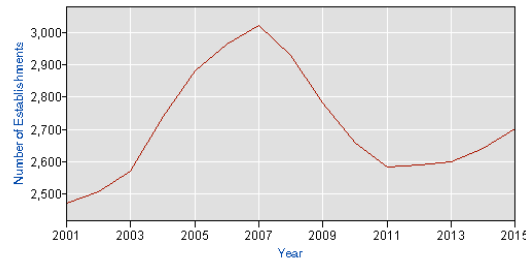
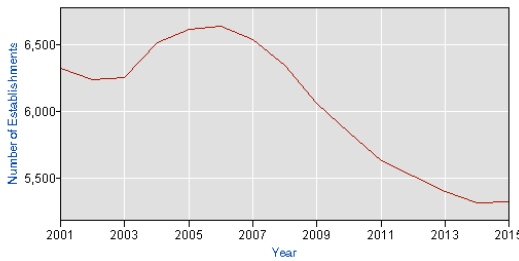
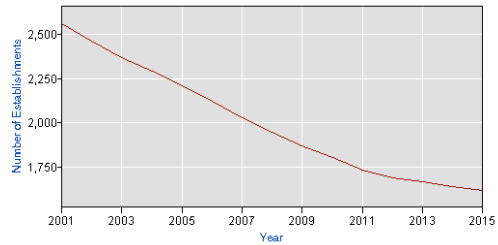
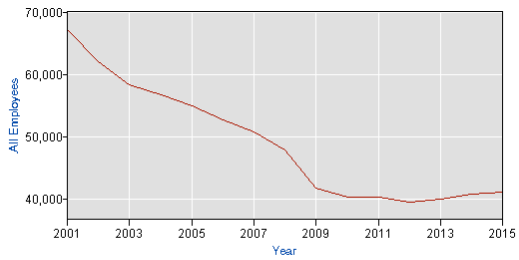
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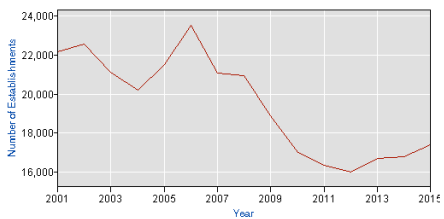
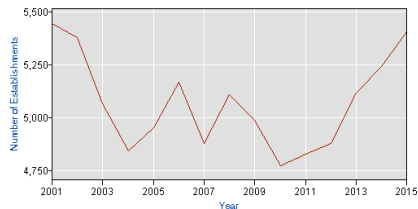
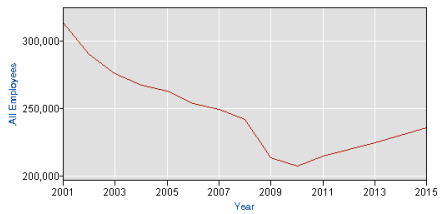
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Rhode Island



South Carolina



South Dakota



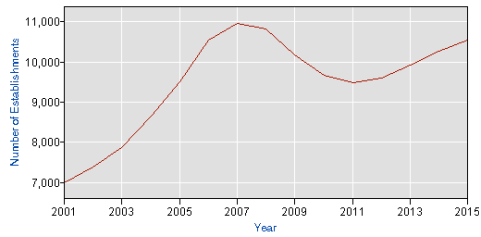
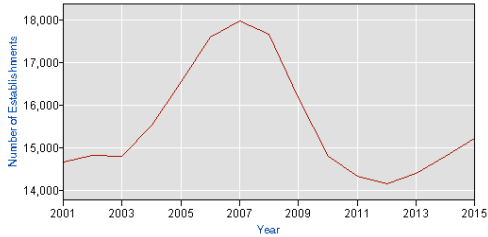
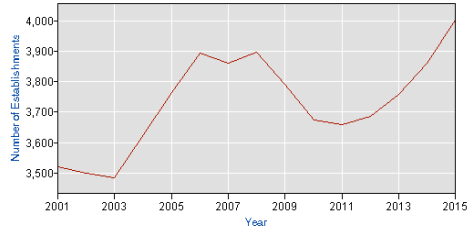
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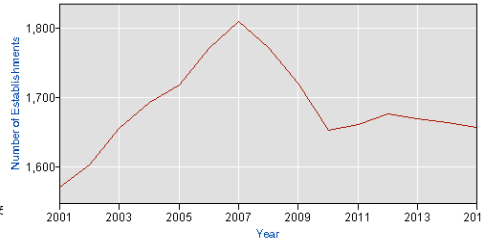
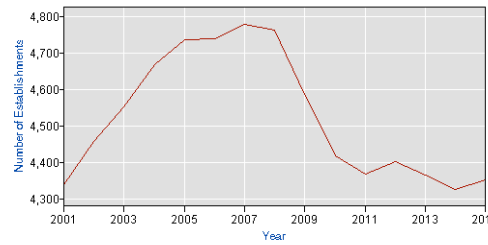
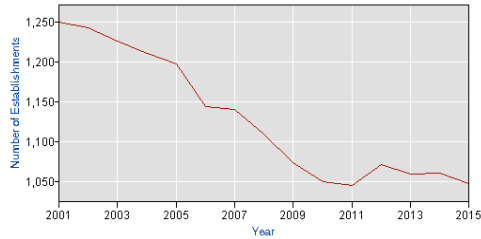
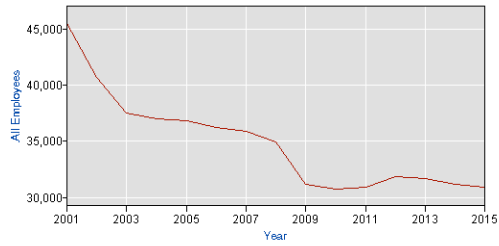
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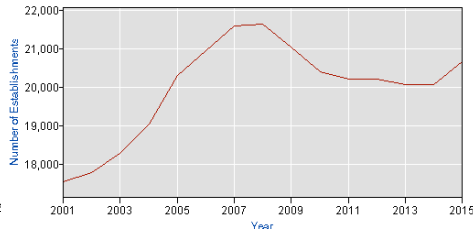
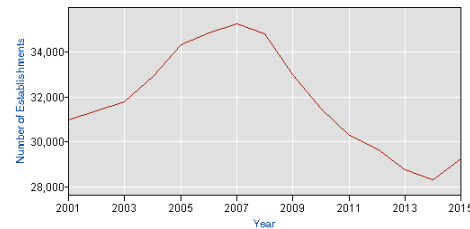
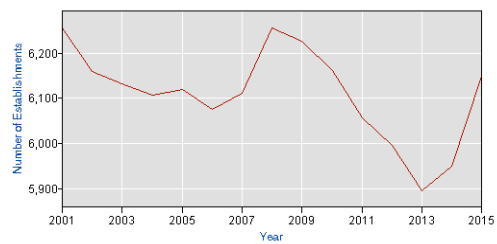
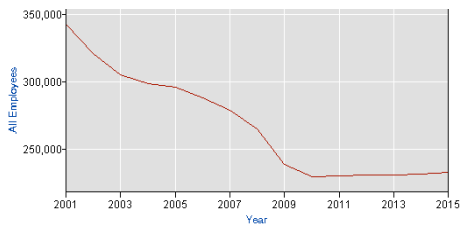
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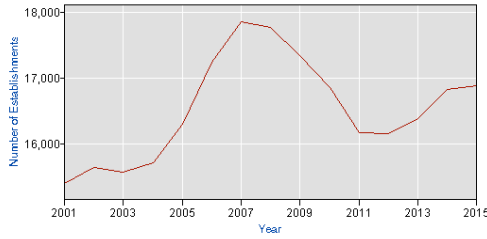
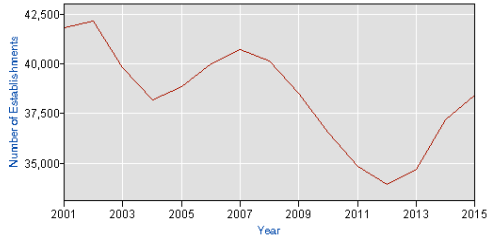
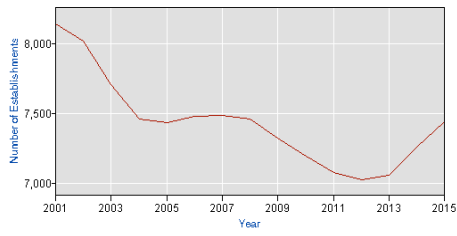
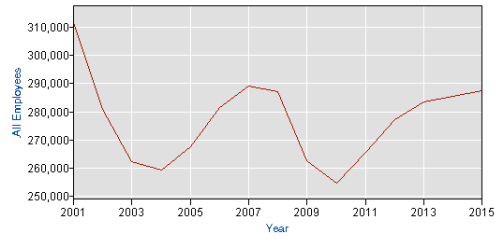
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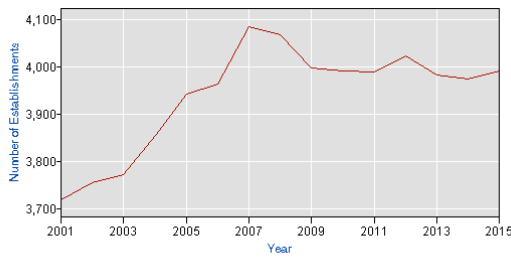
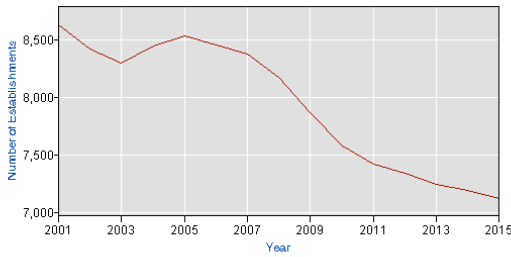
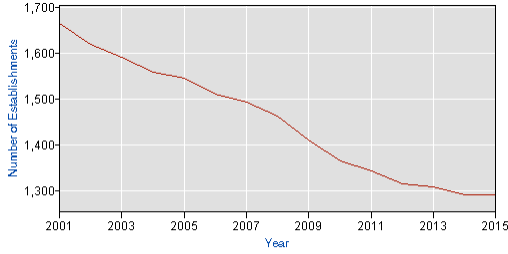
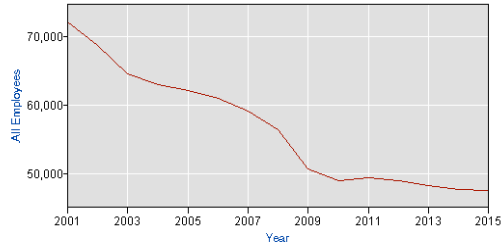
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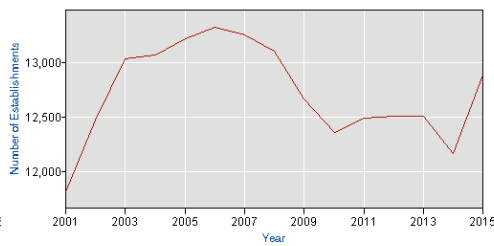
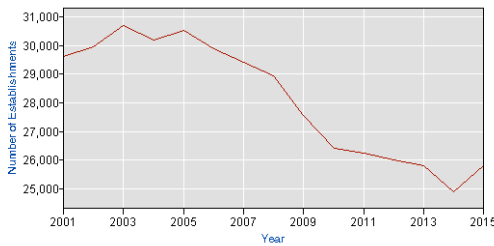
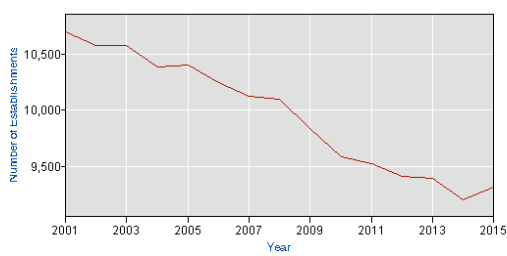
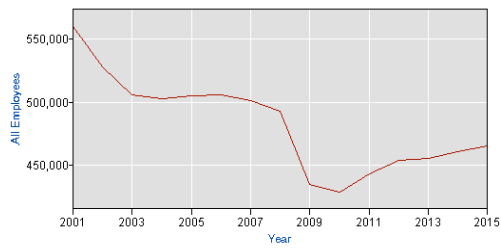
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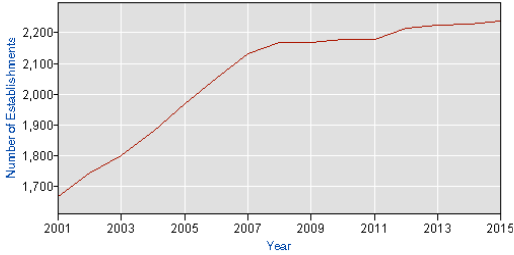
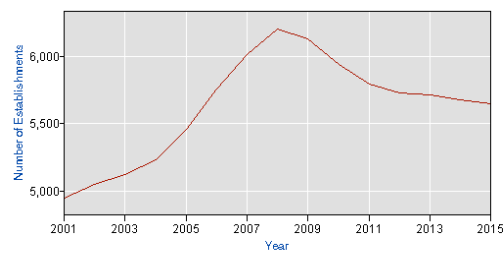
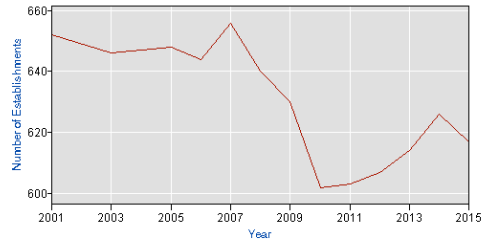
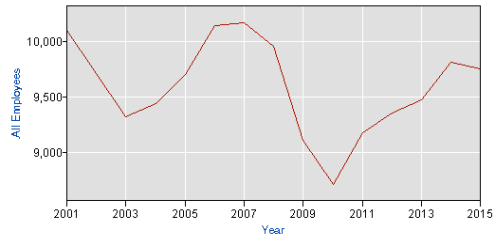
West Virginia



Wisconsin



Wyoming



Chapter 5: Analysis of Data and Conclusion

5.1: Analysis of National Data

The national data for firm births and deaths indicate that small firms dominate the market and the trend of total firm births and deaths correlate with the success of small firms. The small firms represent the greater share of national employment, but it has decreased over the decades with the greater number of large firms. Although the large firms offer lower wages and create less employment, the total number of large firms is increasing as the death rate of them has fallen. Fluctuations in the early 2000's and after the last economic crisis indicate that regulation is aimed at the creation and survival of large firms. The large spike in birth rates of large firms corresponded with legislation that targeted the creation of corporations by billionaires.

The investment and funding of these corporations sucked funding from small firms reducing their creation and survival. The steady decline in deaths of large firms following the influx of many large firms into the economy indicates that increased funding was needed to support their survival. Although the total number of large firm births decreased on the national level, the dramatic fall in large firm deaths show that corporations were prevailing. The instability of financialization can be seen in the falling death rate because it is the ideal representation of "too big to fail" corporations. The steady birth and death rates of small firms indicate a natural business cycle funding the creation and survival of firms to correspond with demand.

The emergence of large corporations into the economy at an unnatural rate will crowd out individual firms because they cannot sustain enough investment or market share to survive. The large corporations that have a much lower death rate compared

with small firms and would eventually make the small firm obsolete if this trend were to continue. If regulation continues to support the survival of large firms and the number of firm deaths approach zero, the small firm will lose all market power. The small firm maintains market power as an institution that represents fair wages, maximum employment, and stable growth. Small firms within all sectors of the economy and throughout every market in the country are essential for employment and the output of real goods and services in the economy, but their overall survival is threatened with the increased influence of large corporations.

The large firms are underselling the smaller firms and cutting into the markets of small firms nationally. The aggregate large firms that exist in the current economy challenge the survival of all small firms because of their ability to access national markets. Small firms that mainly serve local markets are at a greater risk because of their inability to interact with the overall economy. Their importance is dismissed because of the minimal impact on the economy. This represents the trend of financialization on the national level because it represents the diminished influence of small firms with the increased protection of corporations.

5.2: Analysis of State Growth Case Study

The analysis of the specific state data that proceeds the national data follows many of the same trends of financialization. The state data that is representative of the strongest and fastest growing state economies in the country also have a falling number of small firms. The aggregate of small firms for these states has fallen since the crisis,

as the total number peaked during the crisis. During the same period, large firms within these states have steadily grown with no specific shocks. The main deviation from the national level is in the sustained growth of large firms. The national level experienced a significant shock to the birth rates of large firms that subsequently contributed to the protection and falling death rates of corporations, but the sustained growth indicates an economy relying more on corporations. The majority of these states are developing corporations and slowly eliminating small firms.

The death rates for these states is not drastic compared with the national level, but the continuous growth and higher birth to death ratio highlight the market power and growing share of the economy for large corporations. The market power that large corporations take from local producers is supported in the rising death of small firms within these states. Although small firms represent the majority of the firms within these states, the death of small firms has exceeded the creation of them following the crisis. The deviation in small firms from these states is a regional approach, as some of the larger states are much more committed to corporations and are not affected by the fall of small firms. The regional deviation of small firms emphasizes the importance of sustained relation lending to the real economy within a state and the importance of real output to maintain stability.

5.3: Analysis of State Data by Region

The individual data that is presented for each state represents the various strengths and weaknesses within the production and financial sectors throughout the country. As the national data and fastest growing state data has now been analyzed, the regional data from the collection of all states will correlate with trends that have already been observed. The purpose of analyzing the states regionally is to challenge the principles of financialization to understand what parts of the country have not fully adopted this new institution and their success in doing so. Nationally regulation and action have favored the diminished lending to small firms in order to sustain corporations, although the growth in states that decide to follow the trends of financialization have weakened job growth because of the decreasing number of small firms. The analysis of the groups of states are divided into 5 regions as they are often categorized with the Northeast, Southeast, Midwest, Southwest, and West. In each region some specific state trends will be noted, as well as the trends that encompass the specific region.

5.4: Northeast

States: *Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont*

The northeast region unsurprisingly follows many trends of financialization that have been noted on a national level. The steady decline of the manufacturing and production sectors within this region over the past century emphasize the worst regionally ingrained case of financialization throughout the country because of the

increased involvement in financial activities. The region has followed a specific trend of financialization that sees a fall in the financial sector with the fall in the production sector because of the inability for relation lenders to fund a real economy. Although New York has the biggest economy in the region and is able to increase the size of their financial sector while real output is falling, they are able to do so because of the benefits of financialization that support corporate bailouts.

Small firms are decreasing in the state after the crisis, but the financial bailouts that have shifted to corporations rather than funding small firms. In order to conceal the true number of small firms and small firm deaths that occur in the state each year small firm deaths are not observed in the state report on small business each year. The state does not recognize the small firm deaths from that year in the aggregate of total small firms inflating actual the number of small firms within the state by almost 50,000. New York's financial success that continues while small firms are failing is unique in the region because many other states have decreased their production firms and financial firms have fallen equivalently. The competition that relation lenders face in smaller states such as New Hampshire, Rhode Island, and even New Jersey is causing stagnation in their financial sectors additionally to falling output. The inability for the financial sector to be supported through small firms because of corporate competition, stops growth in both sectors. The majority of states that had a falling number of manufacturing or goods producing firms did not sustain growth in the financial sector either. The only state in the region (Delaware) that increased the total number of small

firms within the manufacturing sector also had the most sustained growth in the financial sector.

5.5: Southeast

States: *Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia*

The Southeast as a whole has one of the fastest growing financial sectors within the country because of the relatively new emergence of financialization within the region. Many of the states within the region have declining production sectors, but growing financial sectors representing the corporate movement and presence within production. The lower average income that exists in these states combined with lower real estate prices have made the area an ideal location for corporate production. The corporations have grown throughout the region because of their increased ability to generate profits through practices of financialization.

The influx of workers into the region correlate with growing financial firms because of the increased population. Although the increased number of financial firms within the region is representative of the creation of small financial firms, they do not represent the funding of small business. The relatively new emergence of financialization in the region is partially in response to the higher percentage of small firms compared with other regions. The corporate producers and institutions are crowding out the creation of small production firms because of the ability for corporations to undersell. The financial sector has grown while output and total firms have fallen because lenders have emerged to welcome new workers, but not new firms.

Florida is one of the only states in the region that is expanding the number of small firms in production because of the emergence of small business lenders that have been created to directly lend to small firms. The corporate build-up in the region has allowed relation lenders to obtain some market share, but mostly fund the migration of workers for corporations.

5.6: Midwest

States: *Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Wisconsin*

The Midwest was one of the hardest hit areas by financialization because production collapsed in the region and financial institutions infrequently recovered without the benefit of a bailout. In States such as Michigan or Minnesota where the production sector has collapsed the financial sector has not recovered either. The bailouts have helped maintain the largest corporations within the states to keep the sectors alive, but the small firms within these states have been destroyed. The inability to maintain real output for these states results in job loss and instability within both sectors that could lead to another crisis.

The direct support in these states to mainly corporations is not going to benefit states or the economy over the long-run because total small firms and jobs will continue to fall. Some states in the region that were once dominated by farming such as Iowa, Kansas, or Nebraska, are following the same trends of financialization in the south because of the corporate opportunity in these areas. The national proximity of these

states has caused them to increase their corporate presence because of the ability to ship throughout the country easily. This leads to the reduction of small firms and an increase in the number of financial institutions within these states. This trend is challenged in the Dakotas for example because of the ability to maintain small firm growth within the production sectors in order for stable growth between all sectors. The lack of corporate influence in these states combined with their locational relation to national markets allows small firms to maintain market power.

5.7: Southwest

States: *Arizona, New Mexico, Oklahoma, Texas*

The trends of financialization that are seen in the Southwest are fairly unique because they represent qualities that are unique to the region, but also seen on the national level. Each state has its own unique relation to financialization because of the maintained production in the region. Arizona is the only state in the region that followed the rise before the crisis and fall proceeding the recession. This trend has been noted for other states as well representing the idea that the financial sector cannot stably grow without sufficient real output. The fall in both sectors indicate that the economy is not supported by enough real investments for either sector to grow. The fall in both sectors represents a disturbance created by corporations limiting the number of small firms in both sectors. The other states in the region have been able to avoid this trend of financialization because both sectors have risen equally.

In Texas and Oklahoma the increased number of small firms within the sectors have allowed for real output to grow during financialization. When financialization has limited production the small firms will not emerge because corporations will crowd them out when enough market share is reached. It is critical to avoid this because output falls in states that have not maintained stability and sectoral collapse will be more severe. The shift in support from small firms to corporations will inhibit growth. The maintained number of firms and jobs will fall when greater support is given to corporations. A deviation that has occurred in this region in regards to employment is New Mexico's falling manufacturing employment while total firms are increasing. The potential impact of migrant labor could have created this shift because of workers coming in from Mexico and not appearing in the national statistics.

5.8: West

States: *Alaska, California, Colorado, Hawaii, Idaho, Montana, Nevada, Oregon, Utah, Washington, Wyoming*

The states in the West region vary immensely because of the variation in economies and location for the states within the region. California is clearly the largest state economy in the country and its economy rivals the economies' of countries throughout the world. California follows the trend of financialization that many other states with established corporations have experienced with the rise and fall of production sectors and the financial sector before and after the crisis. This notion supports the main theory that sustained growth will not be possible if both sectors are

not growing simultaneously. The financial sector can grow when new corporations are added to the economy, but growth will not continue once real output has fallen below financial output.

This concept is seen in multiples states in the Western region where developing real estate markets are popular such as Colorado, Hawaii, and Idaho as they built up their financial sectors only to watch them collapse with the reduction of real output. The sectors have strengthened when output and firms in the real economy are supported by small financial firms that continue to grow. In a state such as Utah the correlation between the increasing number of small firms producing real goods and services and growth of the financial sector is specifically important because of the commitment to the funding of small firms. In Utah, it is home to one of the top lenders to small firms in the country in Celtic National bank, which was created for the continued funding of small firms. This institution represents the possibility for sustained small firm lending that will force corporations to relinquish market power throughout the country. It is important for these institutions to exist because they represent the survival of small firms on a macro and micro level. The smaller and more isolated states in the region that avoid financialization continue to add small firms because of the lack of macroeconomic effects that create instability in the national markets.

5.8: Conclusion and Future Policy Implications

The long term impact of financialization has multiple negative effects on the stability and growth of the economy, but the results from financialization are not a definitive conclusion. The international competition and jobs that have been lost

because of financialization are unlikely to return in the same capacity, but it does not indicate that the sectors that once held these jobs are doomed. Financializations impact on innovation and technology is a crucial factor that is not considered in the rise of finance and the fall in the real economy.

The ability to generate profits through financial intermediation has become more efficient than the sale of American goods and services because innovation is lagging. Policy implications currently in place do not protect the continued funding of small firms because it allows corporations to reduce market share for all small firms. Small firms that do not innovate because of a lack of funding will not survive because they are not helped by federal regulation and consumers will instead choose to give the corporation's business. The phenomenon that has arisen with the rise of corporations is the barriers to entry that new small firms face against established corporate giants. The barriers to entry ignore the notion of innovation and unfulfilled demand that corporations are creating within the economy.

The barriers to entry are partially created by the period of deregulation that the sector has undergone. Minsky's theory on the ebb and flow of regulation and deregulation⁹⁴ is crucial because of the period of deregulation that has followed the crisis, combined with the growth of the financial sector. The deregulation within the financial sector has improved economic conditions and improved spending, but the spending has not been efficiently contributing to the real economy. The expenditures of the wealthiest hedge funds and investment banks throughout the country are risky and

⁹⁴ WRAY, L. RANDALL. *WHY MINSKY MATTERS*. S.I.: PRINCETON UNIVERSITY PRESS, 2017.

do not help the entire economy grow. The deregulation that's created this paradox in the economy is self reinforcing because when investors are unsuccessful the entire economy suffers, while their success and profitability does not correlate with prosperity throughout the economy. The economy is not growing sustainably because of the accumulation of wealth for individuals in the top 1% and the steady decline for the rest of the population, specifically the bottom half of the economy.

This notion supports the need for increased regulation in order to induce spending from the entire economy. Financialization is not hurting the economy because of the growing financial sector or the increased profitability of investors, but the loss of jobs and reduction in spending from a large portion of the economy. Although regulation is put in place towards corporate behavior and spending, the regulation needs to favor the future creation of small firms and increased spending on real goods in the economy. The liquidity trap that's been created for the highest earners can not sufficiently spend to keep the economy growing. The reduction in liquidity for a majority of the population has weakened consumer spending and as a result the existence of small firms. The regulation should be aimed at improving these factors because this population exists as spenders while the highest earning investors are responsible for inducing spending. The regulation does not need to change the system and who is investing in the economy, but change the velocity of loans to induce firm creation, job creation, and widespread consumer spending.

These three effects that happened because of the spread of financialization throughout the real economy is representative of growing consumer debt and inequality

that is seen in consumer support for corporations. The increasing size and popularity of Walmart represents growing consumer debt because consumers are forced to shop at the “one stop shop” because of low prices and command of market share. The encroachment of Walmart and other corporations into local markets decimate small firms and job growth because they capture local market power. The control of an inordinate share of market power allows them to control the local economies that they inhabit. Their control of local economies extends beyond the market reach of the corporations and dictates the behavior of all firms within the smaller economy. Walmart’s control of the supply of local produce in every state, regardless of financial growth or the store’s presence,⁹⁵ indicates a market share that has exceeded its natural limit. The impact of financialization in this circumstance has slowed growth outside of the corporation and ultimately created future barriers to entry for new firms. The market control of corporations is not sustainable for economic success because multi-sector job growth and consumer spending will not be maximized. Regulation needs to focus on the creation of small firms into developing or new sectors of the economy. Lending needs to be maximized for the creation of these small firms and minimum standards need to be set for lenders ratio of small business loans to total assets.

⁹⁵Haiven, M. "Walmart, Financialization, and the Cultural Politics of Securitization." *Cultural Politics an International Journal* 9, no. 3 (2013): 239-62. doi:10.1215/17432197-2346964.

5.9: Conclusion

The developing and new sectors of the economy that firm growth could be put forth in do not need to be entirely new, but innovate existing industries and problems. The rising energy costs, that create more expensive transportation, and causes exports to be more expensive could be improved through regulation and innovations within these industries. The creation of small firms that cater to niche demands within smaller economies also contribute to industries nationally and will have a greater overall impact because of their macroeconomic effect, as opposed to dominating a microeconomic market. For example a Walmart in New York will not be beneficial outside of their particular New York market, but small firms that are replaced by Walmart will benefit other markets outside the local market they are in. The existence of niche demands and factors of production that rely on a functioning business cycle are impeded when a single firm integrates the industry. The integration of corporations excludes niche demands and further innovation within industries. Innovations need to stem from the creation of small firms innovating and becoming more efficient in their own industries. The energy industry is faltering nationally, as innovation has slowed down because of financialization. Similarly in the agriculture sector, innovation has declined because financialization has created market power that has undermined competition. The rising costs for consumers show that innovations are needed in order to strengthen these industries resulting in firm growth, job growth, and lower prices to consumers. This will allow financialization to continue, but continually expand the entire economy.

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