How finance reshaped America

Jerry Davis
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How did we get into this mess?

“There's no question about it. Wall Street got drunk”
G.W. Bush, 7/08

CORRECTION:

The American economy got drunk. Wall Street was just the bartender.

Wall Street is Main Street now

• Half of US households are invested in the stock market through mutual funds and 401(k) plans
• Thanks to mortgage securitization and low interest rates, most homeowners with mortgages refinanced them during the first half of this decade
• The personal savings rate (employment income – spending) in the US turned negative in 2005 for the first time since the Great Depression
• But don’t worry:
  “The decline in an often-cited aggregate personal saving rate may not be cause for much alarm for retirement preparedness. Much of this decline can be attributed to spending triggered by wealth increases from capital gains on housing and financial assets.” (Economic Report of the President 2006)
Due to this “wealth effect,” the housing bubble disguised weaknesses in the real economy

- Americans extracted perhaps $800 billion per year in home equity from 2004-2006 – about 9% of US disposable income (Greenspan and Kennedy, 2008)
- Housing price increases fueled economic activity and job creation in retail and housing sectors
  - One-quarter of new jobs created between 2003-2006 were in housing-related industries
  - There were 400,000 mortgage brokers in 2006
  - And 1.2 million real estate agents
  - Roughly $300B/year went for personal consumption, promoting growth in retail employment

The mortgage crisis is a symptom of a broader transition in economic institutions

- The US has shifted from an industrial to a post-industrial economy
- Employees are less tied to particular employers located in particular places
- Households are more tied to financial markets through college and retirement savings invested in mutual funds, credit card payments tied to LIBOR, and mortgages ultimately owned by dozens of different financial institutions

Post-industrialism (def. 1): “the majority of the labor force is no longer engaged in agriculture or manufacturing but in services” (Daniel Bell, 1973)

Was the housing crash utterly unpredictable?

“The magnitude of the current boom is practically unique in history, making it difficult to predict what comes next based on historical examples…It’s notable that until the recent explosion in home prices, real home prices in the United States were virtually unchanged from 1890 to the late 1990s.”

Robert Shiller, March 2006
Manufacturing employment is increasingly rare in the US

Since January 2001, the US has shed 4.8 million jobs in manufacturing—more than one in four

As of last month, more Americans were unemployed than were employed in manufacturing

The US still leads in manufacturing value-added…

The largest US employers have shifted from manufacturing to retail and other services

10 Largest US Corporate Employers, 1960-2009

1960 1980 2009
GM AT&T WAL-MART
AT&T GM TARGET
FORD FORD UPS
GE GE KROGER
US STEEL SEARS SEARS HLDGS
SEARS IBM “AT&T”
A&P ITT HOME DEPOT
EXXON KMART WALGREEN
BETH. STEEL MOBIL VERIZON
ITT GTE SUPERVALU

Wal-Mart now employs roughly as many Americans as the 20 largest manufacturers combined

...it just doesn’t require employees to do it (cf. agriculture)
Ten industries with most-tenured employees

<table>
<thead>
<tr>
<th>Industry</th>
<th>Tenure</th>
<th>Age</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>14</td>
<td>47</td>
<td>1.6</td>
</tr>
<tr>
<td>Utilities</td>
<td>13</td>
<td>45</td>
<td>0.9</td>
</tr>
<tr>
<td>Petroleum and coal products mfg</td>
<td>11</td>
<td>45</td>
<td>0.1</td>
</tr>
<tr>
<td>Forestry, logging, fishing, hunting</td>
<td>10</td>
<td>44</td>
<td>0.2</td>
</tr>
<tr>
<td>Electrical equipment, appliance mfg</td>
<td>10</td>
<td>46</td>
<td>0.3</td>
</tr>
<tr>
<td>Public administration</td>
<td>9</td>
<td>45</td>
<td>4.9</td>
</tr>
<tr>
<td>Transportation equipment manufacturing</td>
<td>8</td>
<td>44</td>
<td>1.4</td>
</tr>
<tr>
<td>Beverage and tobacco products</td>
<td>8</td>
<td>38.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Paper and printing</td>
<td>8</td>
<td>43</td>
<td>0.9</td>
</tr>
<tr>
<td>Primary metals and fabricated metal prods.</td>
<td>7</td>
<td>43</td>
<td>1.4</td>
</tr>
</tbody>
</table>


Ten industries with least-tenured employees

<table>
<thead>
<tr>
<th>Industry</th>
<th>Avg tenure</th>
<th>Age</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internet publishing and broadcasting</td>
<td>0.5</td>
<td>42.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Food services and drinking places</td>
<td>1.5</td>
<td>26</td>
<td>5.0</td>
</tr>
<tr>
<td>Private households</td>
<td>2</td>
<td>40</td>
<td>0.6</td>
</tr>
<tr>
<td>Retail trade</td>
<td>3</td>
<td>38</td>
<td>11.9</td>
</tr>
<tr>
<td>Motion picture and sound recording</td>
<td>3</td>
<td>34</td>
<td>0.3</td>
</tr>
<tr>
<td>Rental and leasing services</td>
<td>3</td>
<td>36</td>
<td>0.4</td>
</tr>
<tr>
<td>Administrative and support services</td>
<td>3</td>
<td>40</td>
<td>3.3</td>
</tr>
<tr>
<td>Social assistance</td>
<td>3</td>
<td>41</td>
<td>2.2</td>
</tr>
<tr>
<td>Arts, entertainment, and recreation</td>
<td>3</td>
<td>38</td>
<td>1.8</td>
</tr>
<tr>
<td>Accommodation</td>
<td>3.5</td>
<td>40</td>
<td>1.3</td>
</tr>
</tbody>
</table>


Ties between companies and employees have frayed

“The whole labor force of the modern corporation is, insofar as possible, turned into a corps of lifetime employees, with great emphasis on stability of employment,” and thus “membership in the modern corporation becomes the single strongest social force shaping its career members…”

Carl Kaysen, 1956

“If there’s one thing you'll learn—and dot-coms have learned it in the last year—is no one can guarantee lifetime employment… You can give lifetime employability by training people, by making them adaptable, making them mobile to go other places to do other things. But you can't guarantee lifetime employment.”

Jack Welch, 2001

Long-term attachments to employees can be costly...

“Our legacy costs in pensions and health care are an area of significant competitive disadvantage for us… We're now subject to global competition. We're running against people who do not have these costs, because they are funded by the government.”

Rick Wagoner, CEO of GM, Feb. 2006
…so most employers have abandoned traditional company pensions in favor of relatively portable 401(k) plans

Retirement Plan Trends: Participation by Plan Type: Distribution of Private-Sector, Active-Worker Participants, 1979-2006

As a result, households became increasingly invested in the stock market during the 1980s and 1990s

% of US households owning stocks, 1964-2007

Specifically: investors in mutual funds

There are many more US mutual funds now


Source: Federal Reserve Survey of Consumer Finances (various years)

Source: U.S. Department of Labor, Form 5500 Survey Report (Summer 2004); EBRI estimates for 2002-2005


And they gathered a lot of assets

Billions of dollars in assets held by US mutual funds


But ‘name brand’ funds got most of the benefit

Market share of top 5 fund families


Leaving US corporate ownership largely ‘intermediated’ by a few mutual funds

Corporate ownership by mutual funds
- 1950: 3%
- 1990: 8%
- 2005: 28%

Mean ownership by institutional investors of 1000 largest corporations

Source: Spectrum 13F database, various years

Fidelity is now the largest shareholder of one in ten US corporations

Number of US-listed firms in which Fidelity is largest shareholder

Source: Spectrum 13F and 13G databases, various years
Q: If household savings have moved to mutual funds, what happened to the banks?

A: They got acquired by Bank of America or JP Morgan Chase

How North Carolina National Bank became Bank of America

How (almost) every New York-based commercial bank became JP Morgan Chase

Bank of America holds nearly 10% of all deposits in the US through its 5800 branches

Of the 10 biggest US banks in 1989, 5 are now part of JP Morgan Chase
The surprising new geography of banking

Ten largest US-based traditional commercial banks

<table>
<thead>
<tr>
<th>Bank</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>JP Morgan Chase</td>
<td>New York</td>
</tr>
<tr>
<td>Bank of America</td>
<td>Charlotte, NC</td>
</tr>
<tr>
<td>Citibank</td>
<td>New York</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>San Francisco</td>
</tr>
<tr>
<td>State Street</td>
<td>Boston</td>
</tr>
<tr>
<td>PNC/National City</td>
<td>Pittsburgh</td>
</tr>
<tr>
<td>US Bank</td>
<td>Minneapolis</td>
</tr>
<tr>
<td>Bank of NY/Mellon</td>
<td>New York</td>
</tr>
<tr>
<td>Suntrust</td>
<td>Atlanta</td>
</tr>
<tr>
<td>Regions Bank</td>
<td>Birmingham, AL</td>
</tr>
</tbody>
</table>

7 of the 10 largest US cities no longer have a major local commercial bank.

Securitization: or, What can be bundled together and sold as bonds?

- Mortgages
- Auto loans
- Student loans
- Corporate loans
- Credit card receivables
- Business receivables (even in distress)
- Settlements of tobacco lawsuits
- David Bowie’s royalties
- Blends of the above (CDOs)
- Your neighbors’ life insurance policies

The basic business of banking has changed

“No, but you... you... you’re thinking of this place all wrong. As if I had the money back in a safe. The money’s not here. Your money’s in Joe’s house... right next to yours. And in the Kennedy house, and Mrs. Macklin’s house, and a hundred others. Why, you’re lending them the money to build, and then, they’re going to pay it back to you as best they can. Now what are you going to do? Foreclose on them?”
Thanks to securitization, a US bank today is often a façade—a portal to financial markets.

A Copernican shift in American society

From a corporate-centered society... to a market-centered society...