How Wall Street reshaped America

Jerry Davis
Ann Arbor City Club
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How did Main Street turn into Wall Street?

- 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

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

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
This represents a Copernican shift in American society

From a corporate-centered society...

...to a market-centered society...

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

Manufacturing employment is increasingly rare in the US

Since January 2001, the US has shed 5.5 million jobs in manufacturing—one in three

As of March 2009, more Americans were unemployed than were employed in manufacturing

The US still leads the world in manufacturing value-added...

Proportion of US private labor force employed in manufacturing and retail, 1939-2010 (Source: BLS)
...it just doesn’t require employees to do it (cf. agriculture)

Lean Factories Find It Hard to Cut Jobs Even in a Slump

By TIMOTHY APPEL and JUSTIN LAHART

SPARTANBURG, S.C. — At a factory here that churns out plastic parts for everything from spray cans to blasting caps, laying off just one worker can be more trouble than it’s worth.

The plant, owned by Cleveland-based Parker Hannifin Corp., has become so lean over the past decade that many assembly lines run with only a handful of highly trained workers.

So while mass layoffs have driven the U.S. unemployment rate to its highest in 26 years, Parker and other companies like it are responding to the slump in more surgical ways, mainly by cutting hours and shedding temporary workers.

"Because of productivity gains, every one of my people earns more dollars in sales today," says Donald Wallisberger, Parker's chief executive. In 2000, the average Parker worker represented about $155,000 a year in sales. Today, that figure tops $200,000. "If I need to cut back, I have to cut back fewer people to achieve the same goal."

Similar trims are taking place at each of Parker's nearly 900 factories. And to varying degrees, this is happening at thousands of other large and small factories across the U.S.

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

10 Largest US Corporate Employers, 1960-2010

<table>
<thead>
<tr>
<th>1960</th>
<th>1980</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>GM</td>
<td>AT&amp;T</td>
<td>WAL-MART</td>
</tr>
<tr>
<td>AT&amp;T</td>
<td>GM</td>
<td>TARGET</td>
</tr>
<tr>
<td>FORD</td>
<td>FORD</td>
<td>UPS</td>
</tr>
<tr>
<td>GE</td>
<td>GE</td>
<td>KROGER</td>
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<tr>
<td>US STEEL</td>
<td>SEARS</td>
<td>HOME DEPOT</td>
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<tr>
<td>SEARS</td>
<td>IBM</td>
<td>SEARS HLDGS</td>
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<tr>
<td>A&amp;P</td>
<td>ITT</td>
<td>“AT&amp;T”</td>
</tr>
<tr>
<td>EXXON</td>
<td>KMARK</td>
<td>WALGREEN</td>
</tr>
<tr>
<td>BETH. STEEL</td>
<td>MOBIL</td>
<td>VERIZON</td>
</tr>
<tr>
<td>ITT</td>
<td>GTE</td>
<td>SAFEWAY</td>
</tr>
</tbody>
</table>

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

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Ten industries with most-tenured employees

<table>
<thead>
<tr>
<th>Industry</th>
<th>Avg 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>


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<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>

Retail jobs are not like manufacturing jobs

- Median hourly wage in “Motor Vehicle Manufacturing” for “Production Occupations” (May 2008): $27.14
- Median hourly wage in “General Merchandise Stores” for “Sales and Related Occupations” (May 2008): $9.33
- Median tenure with current employer in “Transportation Equipment Manufacturing” (Jan. 2004 CPS): 8 years
- Median tenure with current employer in “Retail Trade”: 3 years
- Mean weekly hours worked at Wal-Mart: 34
- Estimated annual turnover at Wal-Mart: 40%

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

Due to the 401(k) plan, most US households are now investors in the stock market
Specifically: investors in mutual funds

Proportion of US households owning mutual funds

Source: Investment Company Institute 2011 Investment Company Fact Book

There are many more US mutual funds now

Number of US mutual funds

Source: Investment Company Institute 2011 Investment Company Fact Book

And they gathered a lot of assets

Billions of dollars in assets held by US mutual funds

Source: Investment Company Institute 2011 Investment Company Fact Book

But name brand funds got most of the benefit

Market share of top 5 fund complexes

Source: Investment Company Institute 2011 Investment Company Fact Book
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 US 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

# of listed firms in US 3833 5187 5828 4423

Source: Spectrum 13F and 13G databases, various years

Increased ownership by institutions has corresponded to increased devotion to “shareholder value”...

• “We exist to create value for our share owners on a long-term basis by building a business that enhances The Coca-Cola Company’s trademarks.”

• “Sara Lee Corporation’s mission is to build leadership brands in consumer packaged goods markets around the world. Our primary purpose is to create long-term stockholder value.”

...and an orientation to share price induced massive restructuring favoring a “Nike model” of production

“Wall Street can wipe you out. They are the rule-setters. They do have their fads, but to a large extent there is an evolution in how they judge companies, and they have decided to give premiums to companies that harbor the most profits for the least assets.”

John Bryan, CEO, explaining Sara Lee’s “de-verticalization” program
Poisonous pet chow containing melamine from China was made by an Ontario-based manufacturer but sold under dozens of different brand names. The global OEM model is not just for Nike anymore.

Some owners were also startled to learn that dozens of competing brands, from discount to premium, are all made by the same company, Menti Foods Inc. of Ontario.

The global OEM model is not just for Nike anymore.
String of Suicides Continues at Electronics Supplier in China

SHANGHAI — A 19-year-old employee was found dead Tuesday morning in what appears to have been the ninth suicide this year at a factory in northern China operated by Foxconn Technology, one of the world’s largest contract electronics manufacturers, according to China’s state-run news media.

Foxconn, which produces electronic and computer components for Apple, Dell, Hewlett-Packard and other global companies, has been struggling this year to explain a string of suicides among young workers at its large plants in the city of Shenzhen, where the company employs about 400,000 workers.

A spokesman for Foxconn, a unit of Hon Hai Precision Industry of Taiwan, could not be reached for comment Tuesday, and the Shenzhen police did not return phone calls. But Xinhua, China’s official news agency, said the Shenzhen police had reported that a young man they identified as Li Hail had apparently jumped to his death at 6:30 a.m. Tuesday at Foxconn.

Wong Tongyin, vice chairman of the general labor union in Shenzhen, a government-controlled organization, said the Shenzhen police had alerted his organization to the death Tuesday.

“We have already sent an investigation team to the factory, and our city government is paying a lot of attention to this,” Mr. Wong said by telephone.

Company executives say Foxconn is planning to hire psychiatrists, counselors and monks, and intends to bring in 2,000 shapers, dummies and gym sitters to improve life on its two sprawling campuses in Shenzhen.

China’s state-run news media also reported Tuesday that Foxconn was building tall fences at its dormitories to prevent workers from jumping to their deaths.

America’s most innovative companies employ few people

- Apple: 60,400
- Google: 32,467
- Facebook: 3000
- Amazon.com: 33,700
- Cisco: 71,825
- Microsoft: 90,000

TOTAL: 291,392

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

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

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

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>US Bank</td>
<td>Minneapolis</td>
</tr>
<tr>
<td>PNC</td>
<td>Pittsburgh</td>
</tr>
<tr>
<td>Bank of NY/Mellon</td>
<td>New York</td>
</tr>
<tr>
<td>Suntrust</td>
<td>Atlanta</td>
</tr>
<tr>
<td>BB&amp;T</td>
<td>Winston-Salem, NC</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
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?”

Banking 2.0: This time, it’s impersonal

“No, but you . . . you . . . you’re thinking of this place all wrong. As if I held your mortgage on my balance sheet. I sold your mortgage to Countrywide 10 minutes after we closed the deal, and they sold it along with 3000 other mortgages to Merrill Lynch, which divided it into bonds that were bought by a Cayman Islands LLC, which bundled them together with other mortgage-backed bonds into a collateralized debt obligation that Citigroup sold to a Norwegian pension fund. Now what are you going to do? Stop making your payments and force those Norwegian retirees to go back to work?”

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
Thanks to securitization, a US bank today is often a façade—a portal to financial markets.

What’s a government to do?

“The interests of a transnational company are not the same as those of the country from which it originates or of the workers it has historically employed. It has become, to coin a phrase, a ‘rootless cosmopolitan.’”

Martin Wolf, *Why Globalization Works*

If you can’t beat ‘em, join ‘em: Governments as vendors in a marketplace of laws

Royal Caribbean International is an international cruise company with 20 cruise ships and 5,446 cabins. The company operates under the Royal Caribbean International and Celebrity Cruises. These brands offer alternative vacation experiences, with themes providing a variety of onboard activities. "Company Description" is not visible in the image.

Incorporation: Liberia

RCL’s 2009 revenues: $5.9 B

Liberia’s 2009 GDP: $1.6 B
The corporate and ship registry for “Liberia” is operated out of an office park near Dulles Airport.