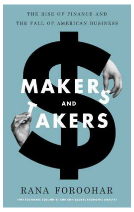

Foroohar R. Makers and Takers

The business of America isn’t business anymore. It’s finance. Financiers dictate terms to American business. American biggest and brightest companies have started to act like banks but they aren’t regulated like banks. The name of our economic illness is financialization that widens the gap between rich and poor, hampers economic progress, threatens the future of American Dream. Makers are people, companies, and ideas that create real economic growth; Takers are those that use our dysfunctional market system mainly to enrich themselves. Finance has become an end, lending decreases, especially long-term lending, trading increases focusing to speculation. The short-term thinking push companies to produce quick-hit result; large and rich companies are involved in financial markets when they don’t need any financing. Finance has transitioned from an industry that encourages healthy risks-taking to one that simply creates debt and spreads unproductive risks. Financialization is aided and abetted by government leaders, policy makers and regulators.

Deep structural dysfunction in our economy, emanating from the financial system, remain in place. Today financial capitalism is fraught with special interests, corporate monopolies (too big to fail) with connections too complicated for the bank risk managers. Complexity creates tremendous risk. Public officials are beholden to the industry (cognitive capture) with incomprehensible rules crafted and controlled by a small cadre of insiders, discussed in a language that only they find comprehensible. Our system is most decidedly not safer. What we need are simpler banking rules that would re-moor finance in the real economy.

Financially oriented managers lead to a culture in which financial metrics (cutting costs) matter more than products, quality and customer satisfaction. It was a shift that put markets before business, capital before labor and profits before anything else. That undermined real growth and innovation. A managerial high caste was being born, separate from owner-entrepreneurs. The quantitative management system was pretty good at increasing efficiency around known goals but terrible at helping people figure out what the goal should actually be, especially when there was a sticky variables at play, like human motivations and emotions.

MBA education today is basically an education in finance, not in business. The managers take the right answers, no matter what the problem is: efficiency, cost optimization, reducing assortment, improving logistic, buy out competitors, getting rid of too many warehouses. They don’t reflect the messy, emotional, dynamic world of business as it is. The real reason is that the incentive structure of board members and CEO are working against long-term decision-making. Business education must become more inclusive, broad-based and socially responsible. Theories espouse a selfish view of the world and detached its roots from morality. Quantitative finance has come to believe that it can have the predictive power of physics, when in reality financial modelling will always be fallible because it is a discipline based on human behavior. Markets are less like rule-based physics and more like messy biological systems (adaptive-market hypothesis).

American’s largest firms haven’t invested more than 1-2 percent of their total asset per year into the real economy and have engaged in public markets to raise money not for real investments but for purpose of financial wizardry. They are using money to bolster markets and enrich the 1 percent instead. The stock option boom incentives bad behavior and creative accounting of all kinds for making each corporation look better than it was. Funneling of corporate earning away from Main Street investments and toward Wall Street (downsize-and-distribute) is an erosion of American competitiveness in global economy. Many nations that have much less market pressure focus more on long-term investment (retain-and-reinvest). Public markets are now a much less attractive place to raise innovation capital given that they push for short-term gains over long-term objectives. Privately owned firms invest more than twice as much in the real economy as public firms. Retirement money too is pushed by short-term thinking. Stock market itself is not unlike a Ponzi scheme. Washington actively encourages the development of finance and deregulation. The financialization is the result of more than thirty years of policy decisions and market shifts.

Non-financial firms derive their growing from their revenues from financial investments, multiple as opposed to more traditional productive activities. This can lead to excessive risk taking and can undermine the company’s future. The amount of trading in derivatives far exceeds the value of real-world investments. Lax regulatory environment, deregulation of interest rates, easy money made the financial sector profits larger and the economy more volatile. The difficult to plan future investment increase the risks of the productive firms. Financialization changed the business culture; the compensation paradigm is ridiculously unfair.

Because investors had more money to put into commodities, these didn't seem to be rising or falling on supply-and-demand dynamic alone. The role of Wall Street fuels volatility in commodities. Derivatives began to explode with an increasing complexity (financial weapons of mass destruction). This pushes food price so high that people go Hungry. Financial institution are allowed to both make the market and to be the market, with possibility of manipulation. People within the financial system are often incentivized to do exactly what's not good for the economy as a whole. Sheer complexity and absence of a single regulatory body big enough to examine complex and problematic deals in their entirely, lead to a dysfunctional market ecosystem. When banks start doing business in areas that involve real, tangible products that people rely on to live, their meddling invariably benefits just them, making money at the expenses of other players. We pick up the bill when thing go bad, thanks to the implicit taxpayer backing of these Too Big to fail institutions.

Wall Street is able to continue to shape the housing market in ways that aren't necessarily in the public benefit, but to maximize the profits, not the wealth creation. Private equity firms perfected the use of debt leverage, asset stripping, tax avoidance and legal machination. Shadow banking, that can deploy debt and leverage with less oversight, started buying up distressed loan portfolios from public lenders like Fannie Mae and Freddie Mac. Government favored lenders over homeowner. Housing prices will be more volatile and tenants and individual owners alike will be more vulnerable to the whims of the Wall Street landlord.

American retirement system has become fragile; more than half of Americans hasn't saved enough money to maintain their current standard of living after they stop working. The retirement system, far from being a safety net, has become an area of major risk. The investments of pension funds are focused on short-term gains, good for funds and companies because are charged by massive fees.

Tax code rewards debt over equity and contribute to the rise of finance and the fall of American business. Capital is misallocated and mispriced. There is actually more debt out there in the world that makes our economy extremely prone to bubble, crisis and stagnation. Tax system push for perverse incentives: job is taxed at a much higher rate than income you earn from your investment.

The power of the financial industry is exerted via regulators and administrative officials, many of whom go through the revolving door between Washington and Wall Street. Many officials tend toward a worldview that is favorable to finance (cognitive capture). The legal shift form a partnership structure to a limited-liability corporate structure was the beginning of moral hazard and has fed into the actual Too Big to Fail financial industry, where gains are privatized but loss are socialized. Far fewer people went to jail during 2008 financial crisis. Dysfunctional relationship between Washington and Wall Street was at the heart of this failure of justice. Financiers and financially captured officials use insider jargon to intimidate and obfuscate, keeping control of the narrative. All this is a threat not just to the financial system and to the economy, but to democracy itself. Today the size of the power of financial sector have brought us to a tipping point which has allowed capitalism to grow, like a virus, beyond its useful life span. Nearly everything becomes transactional: human relationships are "social capital", people themselves become "human capital", and opportunities of any kind must be "monetized". Model of finance has become the model for the economy and for the society as a whole, increasing inequality and undermining economic growth.

Some big ideas for how to move toward a financial system that helps the business and the society, because a well-functioning financial system is a prerequisite for a well-functioning economy, not to mention a healthy democracy:

to make our financial system a lot simpler and a lot more transparent is essential to build a capitalism for the people (Zingales); we need to end the cult of "expert" and to stop treating banking as if it's a business unlike any other (Admati, Hellwig);

less debt, more equity, encouraging savings (Turner);

to stop the shareholder-value culture end consider that the companies are for workers and taxpayers too, limiting the amount and size of buybacks, raising capital gain taxes, using a sliding scale that accounts for how long an asset is held, limiting the amount of corporate pay that can be awarded in stock options, ect;

change the narrative empowering the makers and develop a new and more accurate story about the role that finance plays in our economy: we need a new model, one that enriches the many rather than the few, markets that are structured fairly, a political economy that isn't captured by money interests.