

# Rethinking the Financialisation of Non-Financial Corporations: A Reappraisal of US Empirical Data

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## ABSTRACT

This article assesses the claims of the shareholder value literature of the effects of financialisation on non-financial corporations and, particularly, the claim that fixed capital accumulation in the United States has been impeded by the increasing financial payments of non-financial corporations, and also by these firms transforming themselves into rentiers. The financialisation explanation of macro patterns assumes that trends in the 1970s and early 1980s are representative of the pre-financialisation era but that is not so. Another complication is the global sphere. The vast expansion of majority-owned foreign affiliates from the mid-1990s suggests that the managers of US non-financial corporations did not abandon growth objectives. Claims about rentierisation also require further investigation. On the one hand, it is misleading to treat all external investment as a financial asset and to assume that corporate dividends provide a robust proxy for financialisation. On the other hand, the shift to external accumulation by US non-financial corporations is obscured due in part to the conceptual limitations of direct investment data, and the widespread strategy of forming non-bank holding companies to funnel cross-border activities.

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## 1. Introduction

The Global Financial Crisis and its aftermath are often cast, within the heterodox economics discourse, as a crisis of financialisation. Weak economic activity is undoubtedly the main reason for the slowdown in accumulation since the crisis. What causative role can be attributed to financialisation in explaining macro patterns before and after the crisis is difficult to assess in part because the term has come to denote an array of phenomena.

This article reappraises empirical data for the United States. Based on this analysis, it is argued that there is a need to rethink the contours of financialisation as it pertains to the activities of non-financial corporations (NFCs). Section Two presents an overview of the shareholder value literature. Instead of shareholders pressuring for the adoption of down-size-and-distribute policies, it is my contention that there has been a power shift to managers, who perceive advantage in shifting operations to the international sphere to expand

foreign market share and to export back to advanced-economy markets while minimising labour costs and taxation.

Section Three highlights shortcomings in the arguments for a rentieralisation of NFC activity; notably, the puzzling tendency to view all international activities as a manifestation of financialisation. It is no longer valid to assume the international sphere is only a minor influence on payment trends for US corporate dividends. A prevalent concern of the shareholder value literature is that share buy-backs necessarily crowd-out productive investment. That concern overlooks the fact that financing for stock repurchases has been mainly from borrowing instead of profits. Swapping equity for debt may be conducive to accumulation if the strategy reduces claims on net income. Additionally, while US NFCs no longer finance domestic activities through equity capital on any substantial scale, the same cannot be said for international activities that are funnelled increasingly through non-bank holding companies.

Section Four examines the financial and operating data for the activities of multinational corporations published by the US Bureau of Economic Analysis (BEA). The data reveals a much greater role for international activities than the data for US Direct Investment Abroad (USDIA) and Foreign Direct Investment in the US (FDIUS) reported on a net directional basis. Interpreting data on the external activities of US parents is complicated by the significant growth in foreign affiliates classified as non-bank holding companies. It appears that the profits and ownership structures of US NFCs are migrating to tax havens along with the wealth of rich households.

Section Five presents concluding comments.

## 2. The Financialisation (and De-nationalisation) of Non-financial Corporations

If our [shareholder value orientation] story were true we would expect that managers and consequently non-financial businesses identify increasingly as rentiers and consequently will also behave as such. We would expect higher dividend payout, lower growth [in fixed investment] and more financial investment of non-financial businesses (Stockhammer 2004b, p. 133).

Since the late 1990s a growing number of researchers have sought to quantify the enhanced role of financial relations in shaping macro patterns mainly in advanced economies. The moniker of ‘financialisation’ was deemed an apt lens for bundling an array of phenomena thought to have come into greater prominence in the global economy circa 1980. Much of the literature has focused on the apparent rise in the power of shareholders over the managers of NFCs.<sup>1</sup> Lazonick and O’Sullivan (2000) encapsulated the effects of the shareholder value mode of corporate governance as altering the investment strategies of NFC managers, from a 1970s orientation of retain-and-reinvest to downsize-and-distribute thereafter.

A primary claim of the shareholder value literature is that productive investment has been displaced by the combination of rising financial payments made by NFCs to the rentier class and by a ‘rentieralisation’ of NFC activity. Financialisation is proclaimed as

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<sup>1</sup>See, for example, Crotty (2002, 2005), Dallery (2009), Dühaupt (2012, 2013), Duménil and Lévy (2004, 2011), Hein (2012), Krippner (2005, 2011), Lazonick (2013), Lazonick and O’Sullivan (2000), Onaran, Stockhammer, and Grafl (2011), Orhan-gazi (2008), Stockhammer (2004a, 2004b, 2005, 2009, 2013), van Treeck (2008).

**Table 1.** US rates of fixed capital accumulation and economic growth, 1950–2013

Annual growth %	1950s–1960s (a)	1970s	1980s	1990s	2000– 2007	2008– 2013	1980–2007 (b)	Change (b) – (a) %
NFC gross fixed investment	8.8	12.1	6.1	7.3	4.3	1.7	6.0	–31
Real GDP (2009 dollars)	4.4	3.2	3.1	3.2	2.7	0.9	3.0	–31
Annual % growth in net stock of US NFC fixed assets								
Current cost	6.1	12.3	6.7	5.0	7.5	1.4	6.3	4
Historical cost	7.6	9.2	8.6	6.3	4.8	3.7	6.7	–12
Chain type quantity indexes	3.7	3.7	2.9	3.0	2.3	1.2	2.7	–25

Source: US Federal Reserve (2015); BEAd (various years).

the major cause of the slowdown in rates of accumulation and real economic growth after 1980 in the US and elsewhere. Determining the extent to which US NFCs curbed accumulation prior to the global financial crisis is not a straightforward matter because it depends on accounting methods, period demarcations and whether or not adjustments are made for external factors. The 1970s stands out as a period during which there were usually high growth rates for fixed investment by US NFCs in both gross and net terms (Table 1). Comparing post-1980 trends to the 1950s–1960s golden age of capitalism may therefore provide a better indicator to ‘normality’ than the 1970s period known as the ‘crisis of overaccumulation’ (Magdoff and Sweezy 1981).

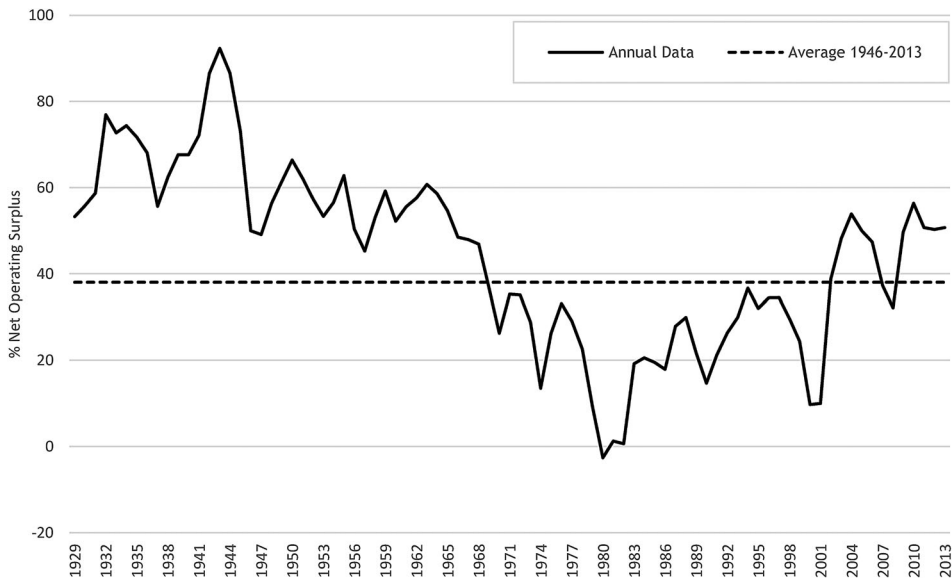
A slowdown in accumulation has undeniably occurred for the US during the neoliberal era. However, what may be true for US domestic NFCs may not be so for US NFCs that operate internationally. Stockhammer (2005, 2009, 2012) points to a falling trend since the 1970s for the ratio of gross fixed capital formation to operating surplus for the private sectors of advanced economies as evidence of investment being displaced by developments in the financial sphere. The so-called ‘investment-profit puzzle’ assumes that macro patterns in the 1970s were representative of the pre-financialisation era. Kliman and Williams (2014) argue that is not so and query why corporate data was not used to show the alleged investment-profit puzzle.<sup>2</sup>

Further insight is gained by considering US NFC profits minus net investment as a proportion of net operating surplus (Figure 1). If there is an investment-profit puzzle, it is why profits were so low *vis-à-vis* net investment in the 1970s and 1980s. Those periods were ones of crisis—the 1970s crisis of overaccumulation and the embrace of monetarism by the US Federal Reserve leading to a high interest rate environment in the 1980s. The framing of an investment-profit puzzle highlights some of the difficulties when attempting to gauge the macro effects of financialisation. Should the elevated rates of fixed capital formation in the 1970s be taken as normal or abnormal? Should the monetarist-induced collapse of profitability in the 1980s be taken as the appropriate reference period to assess the rise thereafter?<sup>3</sup>

Kliman and Williams (2014) proffer two main reasons as to why financialisation did not crowd-out productive investment. The first, as noted, is that the 1970s and early 1980s are unrepresentative of the ‘normal’ relation between investment and profits:

<sup>2</sup>Kliman and Williams (2014, p. 14, fn. 18) report that Stockhammer’s (2009) investment data was for the total economy not the private sector as claimed.

<sup>3</sup>Rentiers gained a greater share of national income as a direct consequence of the high interest rates in the late 1970s to early 1980s. Note that it is financial firms which tend to make profits without much investment.



**Figure 1.** US NFC profits minus net investment as percentage of net operating surplus, 1929–2013\*  
 \* Net investment is the change in the net stock of fixed assets at historical cost. Profits is before tax with IVA and CCAdj.  
 Source: BEAd (various years).

Data series that begin with the 1970s or later do not allow us to draw valid conclusions about how financialisation and neoliberalism have affected productive investment ... Although the investment share [as a percentage of profits] did decline after the early 1980s, it did so because the investment share at the start of the 1980s was abnormally high and unsustainable, not because profit was diverted from productive investment toward financial uses (Kliman and Williams 2014, pp. 15, 20).

The second reason is that higher financial payments and increased purchases of financial assets need not displace productive investment, as NFCs can make use of borrowed funds. These observations are around the mark. However, Kliman and Williams (2014) do not query other aspects of the financialisation narrative, such as the trend towards rising financial payments and financial acquisitions by US NFCs. This article scrutinises these claims made by the shareholder value literature.

## 2.1 External Activities are Not Necessarily a Symptom of Financialisation

In the finance-dominated regime, the ability of managers to pursue long-term growth objectives is said to be increasingly constrained by rising shareholder power and shareholder demands for high financial returns over a short-term horizon. Stockhammer (2004a, 2004b, 2005) and Crotty (2002, 2005) reach a similar conclusion, that the rising shareholder value orientation was primarily responsible for a slowdown in accumulation, although Stockhammer places a greater emphasis on rentier preferences. Crotty (2002) urges caution regarding measures signalling a rise in rentierisation activities, whereas Krippner (2005) suggests otherwise, underlining a rise in US NFC ‘portfolio income’ to cash flow.<sup>4</sup> Orhangazi (2008) examines the ‘drain’ and ‘pull’ sides to financialisation at

both the national and industry level. He concludes that growth in net financial payments, combined with greater prospects of making profits through financial activities, worked to crowd-out fixed investment. Similarly, van Treeck (2008) and Dünhaupt (2013) report evidence for the ‘drain’ side.

Many econometric studies use dividend and interest payments as a proxy for financialisation, although the rationale is not always made explicit. The proxies have also expanded into measures that are difficult to interpret. For example, Stockhammer (2013) uses financial globalisation as a proxy. While the boundaries between financial globalisation and financialisation do overlap, using the ‘logarithm of external assets plus external liabilities divided by GDP [gross domestic product]’ (Stockhammer 2013, p. 19) seems too broad. Short-term financial assets may provide a better gauge of the short-termism and rising financial investment aspects of the financialisation lens. Stockhammer (2013, p. 8) remarks that ‘FDI [foreign direct investment] flows illustrate the difficulties in distinguishing between financial globalization and globalization in production’. Distinguishing that boundary is a limitation of empirical studies into the macro effects of financialisation. The standard treatment amongst heterodox economists is to adopt the domestic-activity lens of the National Income and Production Accounts (NIPA):

In flow of funds accounts, USDIA is treated as a financial asset and the corresponding income (dividends received, foreign earnings retained abroad, and holding gains on capital) as a financial income (as in the general case of dividends paid by affiliates when the accounts are not consolidated) ... It is possible to compute a specific profit rate for USDIA, treated in the national accounting framework as a financial asset but whose ‘financial’ character is questionable (Duménil and Lévy 2004, pp. 94, 100).

Within the confines of the NIPA, all foreign income streams may be considered financial in nature, insofar as they are not generated from the current production of domestic sectors. At the same time it is the underlying activity that determines whether an income stream is of a financial or productive nature. There is no reason to view *all* direct investment as evidence of financialisation. Crotty (2002, p. 35) suggests that outward direct investment ‘is normally considered a real investment,’ and it may well be. Duménil and Lévy’s (2004) caveat that the financial character of USDIA can be questioned was proffered in a dot-point conclusion. The subject warrants more consideration as it may be critical to whether it can be said that financialisation is manifest in ‘the simultaneous growth of the financial assets and debt of non-financial corporations ... [and the] rise of the proportion of financial income in [NFC] total profits’ (*ibid*, pp. 90–91).

For cross-border investment to be considered as direct investment in international statistics, the ownership stake must be at least 10 per cent. The overwhelming majority of USDIA by national NFCs is majority-owned.<sup>5</sup> Perhaps ownership stakes of 10 per cent could be regarded as rentierisation in the form of speculating on foreign equity markets and those above 10 per cent as indicating a longer-term commitment to the development of operations outside US borders. The international sphere also influences trends in corporate dividends. In fact, it is my contention that, as the cross-border activities of US

<sup>4</sup>Krippner (2005) also underscores a shift in profitability post-1980 from non-financial to financial corporations as did Duménil and Lévy’s (2004) study.

<sup>5</sup>According to the BEA’s financial and operating data for the US multinational enterprises, the assets of majority-owned foreign affiliates to those of all foreign affiliates rose from an average of 84.7 per cent during 1990–2004 to 90.1 per cent during 2005–2012 (BEAb).

NFCs may now be of near-equal importance to domestic activities, there are serious difficulties when using corporate dividends as a proxy of financialisation.<sup>6</sup>

It should also be noted that the shareholder value literature tends to overstate the importance of an internal power transfer from firm managers to shareholders, while underestimating the incentives of the managerial class to pursue growth objectives. CEOs seized on the rhetoric of creating shareholder value to enrich themselves with a manager-friendly pay regime gained, in part, by squeezing ‘ordinary labour’ (Lavoie 2009). Boyer (2005, p. 8) heralds a shift from shareholder value to CEO power in view of remuneration remaining at high levels after the 1990s tech bubble burst, as ‘managers have used the pressures of institutional investors and diverted them to their own benefit.’ And while CEO stock options are an important part of contemporary managerial pay, Gregg et al.’s (2012, p. 117) study of UK financial and non-financial corporations demonstrates that ‘the primary factor related to executive pay appears to be firm size’.

A key point is that from the late 1990s the managers of US national NFCs shifted operations and financial wealth increasingly from the domestic to the international sphere. This development cannot be attributed solely to financial pressures but a combination of motives including tax minimisation and growth objectives (for example, expanding shares in foreign markets). Palley (2007) expresses concern about the role of global outsourcing to low-wage nations in depressing investment and employment conditions, especially in the US manufacturing sector, and more generally for all US export and import competing industries.<sup>7</sup>

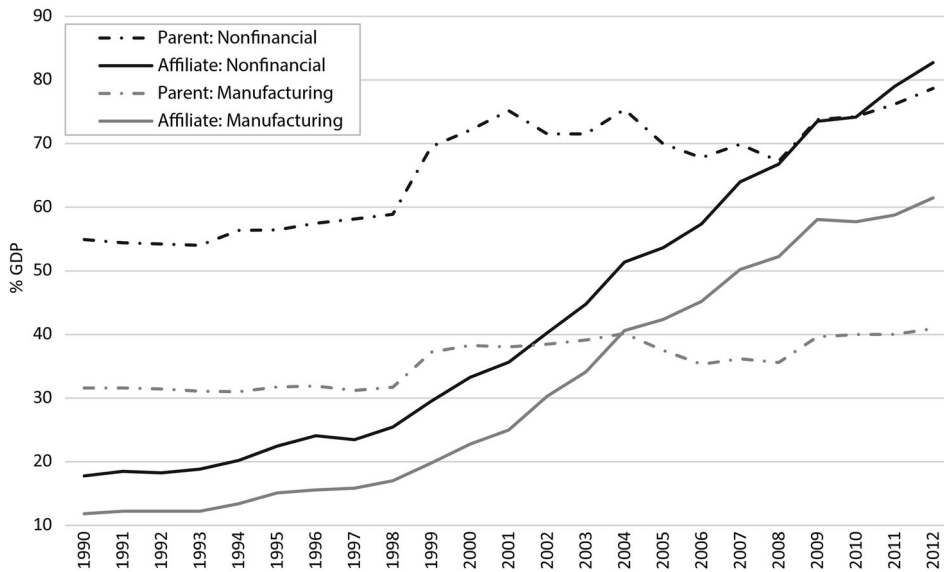
In 2007, 27 per cent of China’s exports to the US were generated by US-owned multinational corporations (Hale and Hale 2008). European and Japanese multinational corporations have also set up platform companies in low-wage nations that are involved significantly, but not exclusively, in labour-intensive manufacturing assembly industries. Some neoliberals went so far as to suggest that the US trade deficit was not even a deficit as it reflects an increasingly globalised world economy, in which ‘our accounting deficits are largely with our own overseas subsidiaries (more than 50% of world trade is intra-company trade)’ (Wilby 2008). With US national NFCs increasingly relocating production facilities abroad (and/or expanding more abroad than at home), while exporting back to US domestic markets (and to other advanced economies), what is in the interests of corporate America is not necessarily in the interests of main street.

Figure 2 shows the total assets of US majority-owned foreign affiliates (MOFA) and their NFC parents (data by industry of parent) scaled against US GDP. The ratio of MOFA assets to that of their NFC parents underwent a meteoric rise from one-third in the mid-1990s to unity by 2008.<sup>8</sup> The trend is even greater for manufacturing firms—with the ratio of MOFA assets to that of their NFC parents—rising from 0.4 times in the 1990s to 1.5 times in 2012. There appears to be a straightforward explanation for the sluggish period during 2000–2007, given that the assets of the MOFAs of US NFC parents increased from 29.5 per cent of US GDP in 1999 to 64.0 per cent in 2007 (refer

<sup>6</sup>As inter-company debt between parents and affiliates is a component of direct investment, then it will also affect proxies of financialisation that use monetary interest paid and received (or net).

<sup>7</sup>Leading up to The Global Financial Crisis the US–China and European Union–China net trade balance shifted in favour of the Chinese (and would have been more so for the European Union if it had not been for Germany).

<sup>8</sup>In 1999 the US BEA changed its classification of sectors (BEAb). The data in Figure 2 has not been adjusted for the pre-1999 classification of non-financial firms. Any adjustment would show negligible difference.



**Figure 2.** Assets of US NFC parents and US-outward NFC MOFAs (data by industry of parent) as percentage of US GDP, 1990–2012

Source: US Federal Reserve (2015); BEAb (various years).

to Table 1). However, care is needed in interpreting the data in part because the direct ownership share of US NFC parents is not known, other than that it is at least 50 per cent.

Is the cross-border expansion of activities by US NFC parents counterbalanced by activities within US borders by foreign parents? Figure 3 charts the assets and owners' equity of US-outward MOFAs and US-inward MOFAs against US GDP for the NFC sector; hence, the data provides insight into how US national NFCs are faring abroad *vis-à-vis* foreign-owned NFCs located within US borders.<sup>9</sup> Figure 3 also shows the stock positions for USDIA and FDIUS for the NFC sector. It is evident that the activities of US-inward NFC MOFAs did not offset the activities of US-outward NFC MOFAs.

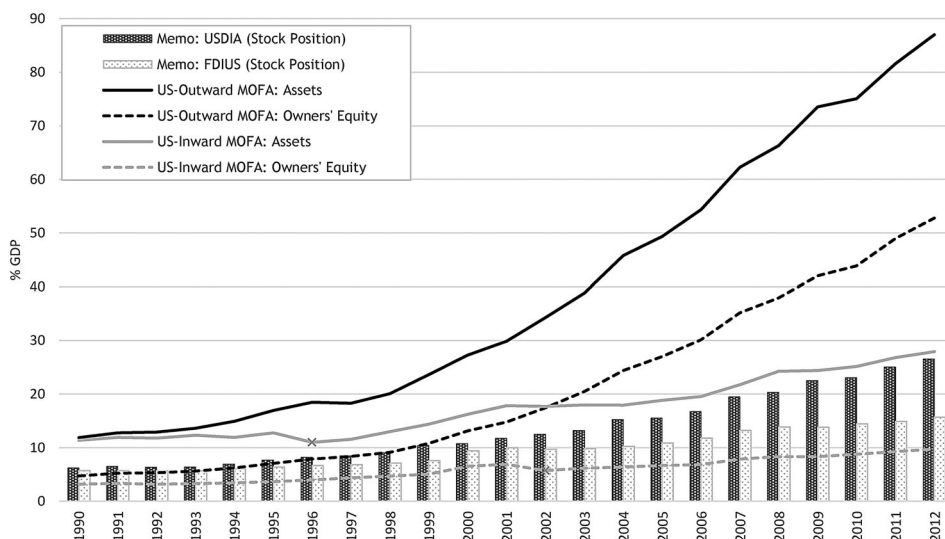
Does the geographic and legal separation of US parents from their affiliates imply the latter are not part of the former, that is, when we speak of a corporation where do the boundaries for analysis begin and end? Would managers distribute dividends only in respect of the profits generated from domestic activities, or the totality of operations?

Figure 3 signals two points. First, claims such as 'the activities of US firms abroad are fairly insignificant relative to the size of the domestic economy, in spite of popular beliefs to the contrary' (Krippner 2005, p. 194), need to be revisited.<sup>10</sup> Second, while it cannot be assumed that growth in assets equates to net new growth in productive capital assets, some of the US-outward NFC MOFA balance sheet expansion must take that form and perhaps a large proportion. At the least, the claim of the shareholder value literature that managers

<sup>9</sup>For FDIUS, and for NFCs, data is available only for the assets of MOFAs after 1995 and for owners' equity after 2001. The crosses in Figure 3 highlight the series break. This is considered immaterial as a majority of FDIUS nonfinancial affiliates are majority-owned (for 1996–2010 the average was 87.4 per cent).

<sup>10</sup>Krippner is referring here to her two main empirical measures of financialisation. There is no debate about an intra-corporate shift in profitability to financial firms at the domestic-level. I do however query the extent of a rise in NFC revenues from financial activities *vis-à-vis* productive activities.





**Figure 3.** Assets and owners' equity of US-outward NFC MOFAs (data by industry of parent) and US-inward NFC MOFAs (data by industry of affiliate) as percentage of US GDP, 1990–2012\*

\*USDIA and FDIUS stocks are reported on a directional basis.

Source: US Federal Reserve (2015); BEAa (various years); BEAb (various years).

of US NFCs abandoned their growth preference cannot be asserted without considering the sector's entire operations.

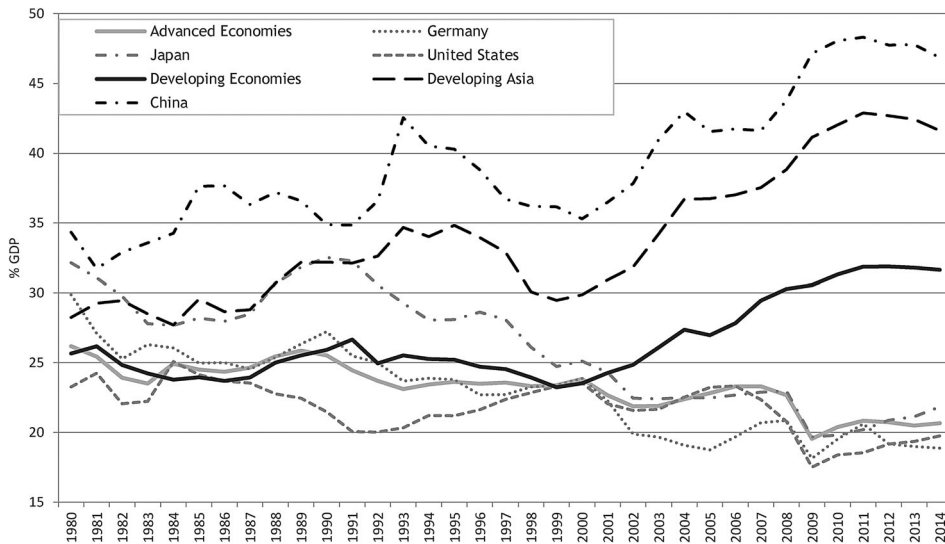
Other advanced economies also experienced a relatively sluggish period prior to the crisis. Subsequently, a good portion of the cross-border expansion by US-based NFCs is likely to have occurred elsewhere.<sup>11</sup> IMF data reveals a downward trend in the contribution of gross investment to GDP for advanced economies since the early 1990s, and a sharp upward trend for developing economies after the 1997–98 East Asian financial crisis (Figure 4).

The falling trend in advanced economies prior to the global financial crisis had much to do with developments in Germany and Japan. While the downward trend since the early 1990s is partly explained by the end of the German unification boom, and in Japan by its 1991 financial crisis, in both countries the role of outward direct investment and increased export competition from low-cost producers are likely to be important.<sup>12</sup> The IMF does not release corporate data, however Figure 4 suggests 'developing Asia' is the hub of the developing world's investment boom and factors other than financialisation may be responsible for crowding-out fixed investment in advanced economies. Alternative explanations would include the

<sup>11</sup> Merger and acquisition activities by US NFC parents are likely to be substantial in both advanced economies and developing economies, although it is reasonable to expect a greater amount of greenfield investment (that is, expansions in productive capacity) has occurred in regions that are faster growing or resource-rich.

<sup>12</sup> Onaran, Stockhammer, and Zwickl (2013) report that direct investment by German multinational firms in low-wage countries crowds out domestic investment. Japan's persistent weakness post-1991 is partly connected to the rise of trading powerhouses in developing Asia, which gained trade competitiveness from industrial policies to assist nationally-owned firms, as well as via technology transfers from advanced-economy multinational firms.





**Figure 4.** Gross investment as percentage of regional GDP, 1980–2014  
Source: IMF (2015).

contradictions of neoliberal free trade and the merits of state-guided industrialisation in East Asia (or something in-between).

Given its focus on advanced economies, the shareholder value discourse tends to ignore the investment boom and robust real GDP growth rates of developing economies after the 1997–98 East Asian financial crisis.<sup>13</sup> Those developments are also puzzling to orthodox economists, given that the aggregate current account of the ‘poor’ financial-capital-deprived developing world shifted from deficit to surplus after 2000. Foreign currency reserves were amassed on a substantial scale through the current account and also by recycling undesired flows of hot-money on the capital account. While the developing world became an aggregate net-exporter of financial capital, this does not preclude advanced economies from building net positions in comparatively high-yielding direct investment. The developing world now owns a proverbial mountain of interest-bearing paper (mainly US federal debt), while US investors own a lot more of the developing world’s productive assets.

### 3. The ‘Pull’ and ‘Drain’ Sides to the Financialisation of NFCs

According to the ‘wisdom of financialisation’ the preference of NFC managers for accumulation has been displaced by rentier preferences.<sup>14</sup> The strategy of substituting physical investment for financial acquisitions is thought to be immensely profitable, as ‘[s]hareholder

<sup>13</sup>Stockhammer (2012, p. 57) recognises external crises in developing economies, although his analysis of the ‘regime of fragile and slow accumulation’ overlooks the marked rise in the proportion of gross investment in the composition of output for developing economies amidst robust annualised real GDP growth rates during 2000–2014 of 6.0 per cent for developing economies and 7.9 per cent for Developing Asia (IMF 2015).

<sup>14</sup>‘[Non-financial] [f]irms do not invest because the rate of return on financial markets is higher, even though they might have the financial resources for investment’ (Stockhammer 2005, p. 211).

power is found to reduce investment and output, while increasing profits, which is consistent with the stylized facts of the neoliberal era' (Stockhammer 2005, p. 193).

This section starts by replicating Krippner's (2005) approach to the 'pull' side of financialisation, which is similar to Stockhammer's (2004a, 2004b), Orhangazi's (2008) and Lin and Tomaskovic-Devey's (2013). Her measure of NFC portfolio income is comprised of realised capital gains, dividends received and interest received. The cash flow denominator is profits before tax plus depreciation allowances minus interest received.

Figure 5 shows that, according to Krippner's (2005) activity-centred measure, US NFCs became more un-financialised/un-rentieralised during the 2000s with the ratio returning to levels prevailing in the mid-1970s. There is a simple explanation—interest received is the largest part of NFC portfolio income and the US federal funds rate has been on a cycle-over-cycle downward trend since 1981. Surprisingly, Krippner (*ibid*) did not discuss the stance of US monetary policy, let alone the US Federal Reserve's ill-fated experiment with monetarist operating procedures in the 1980s. Two interrelated dynamics drove the portfolio income to cash flow ratio to peaks during the 1980s, both of which point to rentieralisation occurring as a by-product of monetary policy. First, when the federal funds rate was raised to record levels in the early 1980s, interest received by NFCs increased along with interest payments. When interest rates were lowered, the ratio rose to a peak in the mid-1980s due mainly to a collapse in the denominator, which fell as a percentage of GDP by two-fifths from 1978 to 1986 because interest paid is a deduction to cash flow.

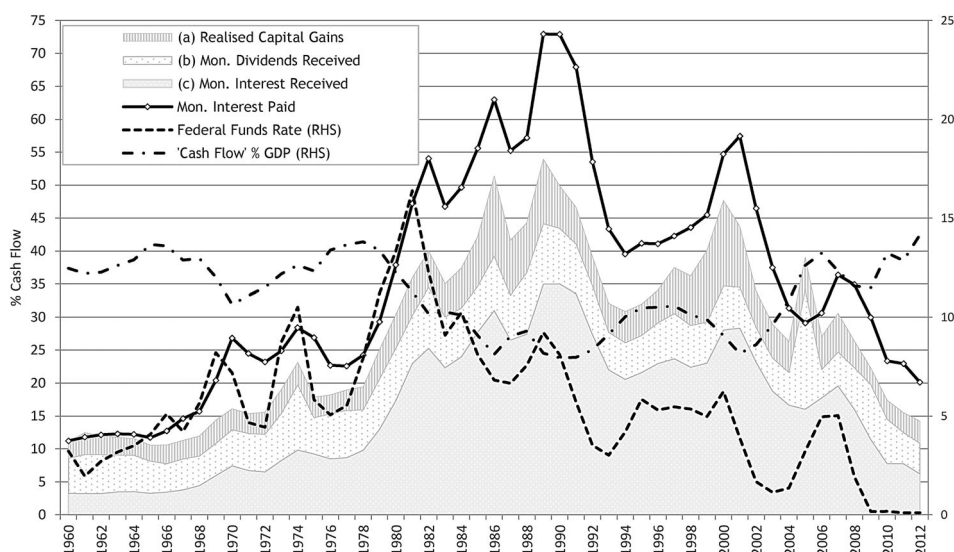
The ratio of interest paid to cash flow is typically above portfolio income, which suggests that rising rentieralisation was not beneficial to US NFCs. One might also expect a sluggish rate of capital accumulation to be correlated with growth in the net interest balance. In the 1980s the 'drain' side appears more compelling than the 'pull' side. Nevertheless, the rise and fall in the level of interest paid principally reflects the stance of US monetary policy.

Onaran, Stockhammer, and Grafl (2011) distinguish rentier income from non-rentier profit income. The latter is defined as the gross operating surplus of private enterprises minus net interest and net dividends. Using data for private enterprises does raise questions of interpretation; for example, it is not clear how either owner-occupied housing or non-profit institutions can be inserted into an explanation of shareholders undermining investment by demanding higher financial payments.<sup>15</sup> Another question concerns whether corporate dividends can provide a robust proxy for financialisation. Cross-border activities complicate the standard interpretation of dividend data as indicating financial rewards or financial pressures.

### 3.1 Trends in NFC Dividends: Financialisation, Rentieralisation or De-nationalisation?

In order to placate shareholders and to keep them quiet, managers have to distribute more dividends. This tendency is an undoubted fact about financialization (Dallery 2009, p. 501).

<sup>15</sup>Certain data trends reported by Onaran, Stockhammer, and Grafl (2011) for private enterprises (e.g. the ratios of gross operating surplus and non-rentier profits to GDP) are not explained by developments in the NFC sector but in the financial sector and owner-occupied housing.



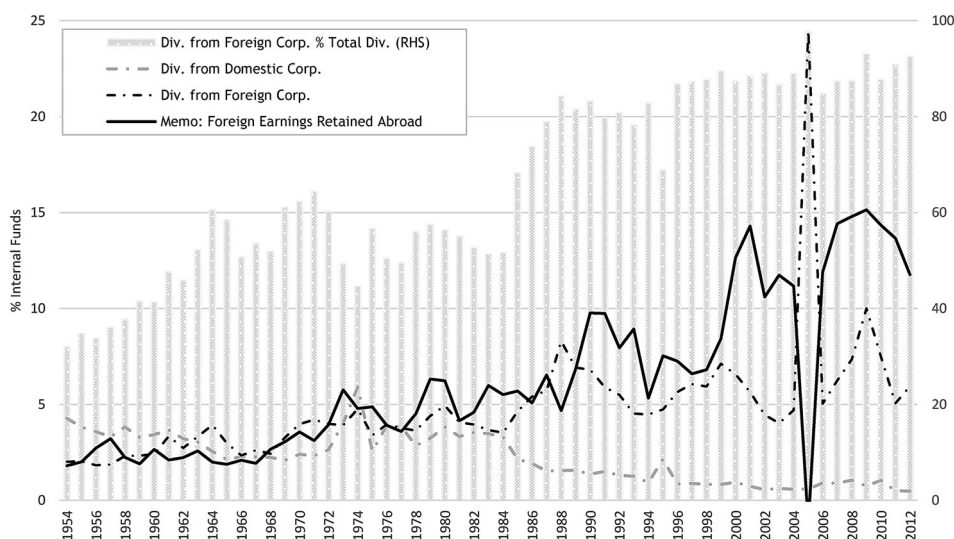
**Figure 5.** US NFC portfolio income as percentage of cash flow, 1960–2012

Source: US Federal Reserve (2015); BEAd (various years); IRS (various years).

Recognising the international sphere poses difficulties for the claim that rising shareholder power has diminished firm ‘animal spirits’. For example, if the assets and income streams of US national NFCs have increased due to cross-border activities, it is reasonable if not expected that managers would distribute more dividends. Similarly, as direct investment income reported on a directional basis includes dividends received as well as reinvested earnings (and net interest on inter-company debt), trends in net dividends may say more about the globalisation of production and subsidiary formation than the phenomena of financialisation.

Let us consider first the more or less constant contribution of dividends received to US NFC portfolio income as a proportion of cash flow (refer to Figure 5). An exception is the spike in 2005 spurred by a one-off tax gift that allowed firms to repatriate earnings at a lower rate. Curiously, when making the case for a financialisation explanation, some heterodox economists use dividends received without acknowledging that the source is mainly from foreign corporations (see Crotty 2002; Stockhammer 2004a, 2004b; Orhangazi 2008; van Treeck 2008; Onaran, Stockhammer, and Grafl 2011). As a proportion of US NFC internal funds, the share of dividends received from foreign corporations rose from one-third during the 1950s to nine-tenths during 2000–2012 (Figure 6).

The official US measure of foreign earnings retained abroad also displays a long-term upward trend, rising from an average of 2.3 per cent of internal funds in the 1950s–1960s, to 12.0 per cent during 2000–2012 (Federal Reserve 2015). Dividends received from foreign corporations and reinvested earnings are reported net of foreign corporate income taxes. The five-fold increase in those income sources as a percentage of US NFC domestic after-tax profits, from an average of 8.6 per cent during 1954–1969 to 43.3 per cent during 2000–2012, provides a partial gauge of the preference of US NFC managers to expand abroad *vis-à-vis* the domestic sphere.



**Figure 6.** US NFC dividends received as percentage of internal funds (book), 1954–2012

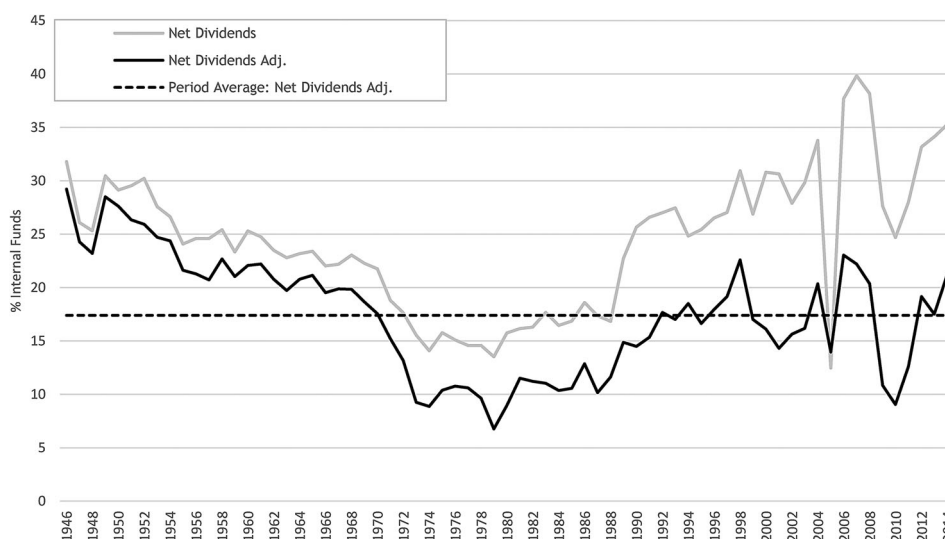
Source: US Federal Reserve (2015); IRS (various years).

Table 2 provides selected US corporate statistics. Three observations are apparent. The first is that the growth in dividends paid is especially marked for financial firms. The rise in the ratio of dividends paid to GDP, from 1958–1969 to 2000–2013, is 317 per cent for financial firms and a more modest 32 per cent for NFCs. Second, lower income taxes and more generous quasi tax breaks through capital consumption allowances may be a reason for NFC managers distributing higher dividends.<sup>16</sup> Third, as noted, higher foreign income may partly explain higher dividend payments.

If lower corporate tax rates and higher income from external activities can explain higher dividend payments, then the claim of impatient shareholders draining NFC funds is much weakened. Figure 7 shows US NFC net dividends as a proportion of internal funds. When foreign earnings retained abroad are included there is still an upward but more modest trend from the late 1970s. Moreover, the overall levels from the mid-1990s are not significantly different from those recorded during the 1950s–1960s golden age. The logic of the data adjustment in Figure 7 is that, as dividends received from foreign corporations are repatriated and foreign earnings retained abroad are not, then a measure of net dividends which excludes the latter will give a misleading view of corporate income (and thus of the ‘drain’ side).

The shareholder value literature claim that US NFCs have been distributing an unusually high amount of net dividends over the last two decades seems to be partly based on both the assumption that data trends during the 1970s are representative of the pre-financialisation era (as per the investment-profit puzzle), as well as insufficient attention to external sources of income.

<sup>16</sup>While higher allowances may be partly justified by an actual shortening of the service lives of fixed capital, Krippner (2005, p. 83) considers that the mandating of more liberal allowances by the US Congress has been a ‘major vehicle for delivering tax breaks to businesses’ over the post-war period, and that one effect is to artificially lower profit rates relative to the 1950s–1960s.



**Figure 7.** US NFC net dividends as percentage of internal funds (book), 1946–2014\*

\*In the adjusted series foreign earnings retained abroad is subtracted from the numerator and added to the denominator.

Source: US Federal Reserve (2015).

**Table 2.** Selected US corporate statistics, 1958–2013

	1958–1969				2000–2013	Change (b) –	Change %
% of GDP	(a)	1970s	1980s	1990s	(b)	(b)	(b)/(a)
Financial corporations monetary dividends paid	0.50	0.47	0.54	1.12	2.08	1.58	317
NFC monetary dividends paid	2.62	2.35	2.43	2.88	3.47	0.85	32
Selected items for NFCs as % of internal funds (book value)							
Monetary dividends paid	31.3	25.0	25.7	34.2	38.8	7.5	24
Monetary dividends received	7.9	8.9	8.3	7.4	8.2	0.3	4
Income taxes	41.8	28.9	19.6	20.1	17.5	–24.4	–58
Capital consumption allowance	67.5	64.9	81.9	88.1	81.5	14.0	21
Foreign earnings retained abroad	2.3	4.4	5.5	7.8	12.1	9.8	432

Source: US Federal Reserve (2015); BEAd (various years).

### 3.2 Rising Financial Investment and Disaccumulation via Share Buy-backs?

The waning of NFC rentier income in Figure 5 raises the question: why are NFCs amassing comparatively low-yielding financial assets? Orhangazi (2008, p. 865, fn. 2) remarks that a ‘significant part of [NFC] financial assets are classified as “miscellaneous” and we do not know what is included in this category’. Flow of funds data does provide a disaggregation of miscellaneous financial assets into identified and unidentified items as per Table 3.<sup>17</sup> It is notable that the aggregated item conventional financial assets has remained a fairly stable share of US GDP. A majority of the expansion in financial investment has occurred in the unidentified miscellaneous category and, to a lesser extent, in USDIA.

<sup>17</sup>Prior to September 2014, USDIA was counted in identified miscellaneous assets.

**Table 3.** US NFC financial assets as percentage of US GDP, 1970–2012

Average for period	1970s	1980s	1990s	2000–2012
Financial assets	42	56	66	92
Conventional Financial assets <sup>a</sup>	26	26	25	27
USDIA (directional basis)	10	10	10	19
Miscellaneous Financial assets	7	20	31	47
Identified	1	2	3	3
Unidentified	6	18	28	44
Financial income as % of financial assets in previous year				
Total return	5.9	7.4	5.9	4.1
USDIA return	9.5	10.7	12.3	10.3
Non-USDIA Return	4.9	6.8	4.8	2.6
% point spread of USDIA return over non-USDIA return	4.6	3.9	7.5	7.7

Source: US Federal Reserve (2015); BEAd (various years); IRS (various years).

<sup>a</sup>Deposits, currency, money market fund shares, security repurchase agreements, credit market assets, trade receivables and mutual fund shares.

Table 3 also estimates US NFC financial returns. Total financial income is interest receipts, dividends received and foreign earnings retained abroad. The USDIA return is dividends received from foreign corporations and foreign earnings retained abroad.<sup>18</sup> During the period 2000–2012 USDIA averaged only one-fifth of NFC financial assets yet provided one-half of financial income at an accelerating rate. The non-USDIA return is dividends received from domestic corporations plus interest receipts as a percentage of financial assets excluding USDIA. The non-USDIA return averaged a paltry 2.6 per cent during the same period suggesting that, if there is a ‘pull’ side to financialisation, it is not very lucrative, or, alternatively, that the composition of income-generating financial assets in the unidentified category is comparatively small. Detailed information from the US Federal Reserve on what is counted in the unidentified category is scarce.<sup>19</sup> Some insight is provided, however, by Smithers (2013, p. 79), citing a no longer published source:

Unidentified miscellaneous assets ... may include such items as deferred charges and prepaid expenses, goodwill, other intangible assets, and intercorporate holdings of corporate equity. Intangibles can include such items as copyrights, patents, distribution rights and agreements, easements (gas, water and mineral rights), franchise fees, trademarks, and client lists.

The stock of NFC unidentified miscellaneous assets was \$7,353 billion at the end of calendar year 2014 signalling there is a large ‘black hole’ shrouding the activities of NFCs. Around two-thirds of that black hole may be found in a benign explanation of intangible assets.<sup>20</sup>

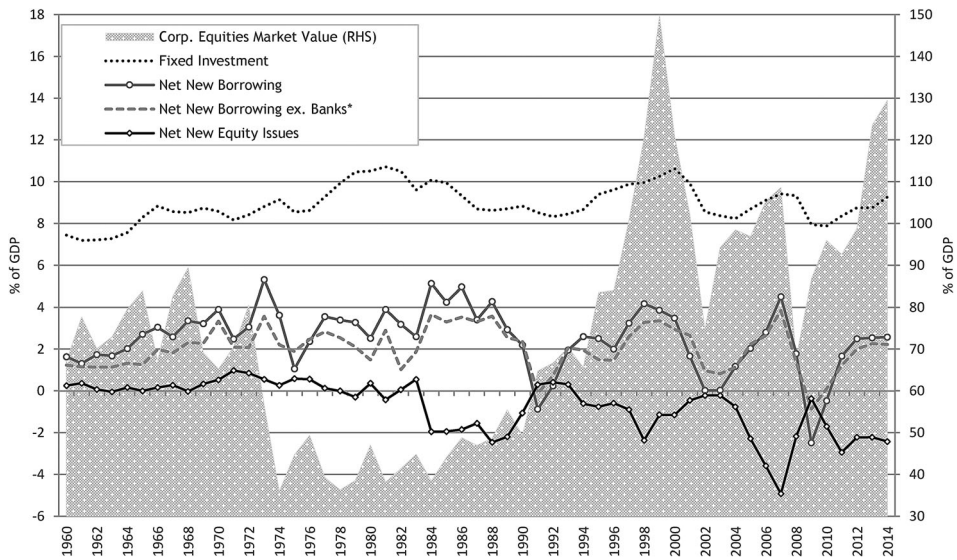
There is also a non-trivial difference between the flow and stock measures of the unidentified category. From 1976 to 2014, the change in the stock of US NFC unidentified miscellaneous assets was \$7,163 billion whereas the cumulative flow was \$4,967 billion. The \$2,196 billion discrepancy may reflect statistical reporting errors, though it could

<sup>18</sup>USDIA is a major source of capital gains for NFCs. The USDIA return should include gross interest received on inter-company debt, although data at the sector level is not available. It should also be noted that it is not possible to discern the extent to which dividends from foreign corporations are from direct investment or portfolio equity investments.

<sup>19</sup>Crotty (2002, p. 35) relays in a personal communication that even Federal Reserve staff do not ‘know what kinds of assets are in “other” financial assets, or even whether all assets in that category are financial.’

<sup>20</sup>In 2012, US NFCs reported \$4,752 billion in intangible assets to the Internal Revenue Service, which was 72 per cent the value of unidentified miscellaneous assets reported in flow of funds data.





**Figure 8.** US NFC fixed investment, borrowing and equity issuance as percentage of US GDP, 1960–2014 \*Excludes bank lending in category ‘not elsewhere classified’.  
Source: US Federal Reserve (2015).

also be because the unidentified category contains assets subject to valuation adjustments. The dwindling role of dividends received from domestic corporations as an income source for NFCs suggests that intra-sector holdings of corporate equities may be minor (refer to Figure 6). A more likely explanation of the discrepancy is the difference between the recording of USDIA stock on a non-directional basis at current cost and the reporting by US NFCs of foreign operations in their financial statements.<sup>21</sup>

The returns for USDIA and non-USDIA in Table 3 may thus be off the mark. The bulk of growth in the financial assets of US NFCs may not be a manifestation of rentier-alisation. Growth in international activities may not be benign as, unlike financial acquisitions or stock repurchases which do not need to displace productive investment as highlighted by Kliman and Williams (2014), there is the potential for a trade-off regarding decisions to expand productive capacity in the domestic sphere versus the international sphere.

Those who attribute changes in managerial behaviour to shareholder value view the trend to large stock repurchases as a telling indicator of the ‘drain’ side of financialisation. Along these lines, Duménil and Lévy (2011, p. 64) consider there is ‘an explicit strategy of “disaccumulation,” with dramatic consequences for the growth of the US economy’. If shareholders had power to influence managerial decisions, then that should materialise through increased share buy-backs during busts to mitigate capital losses for shareholders. However, the data in Figure 8 shows a pro-cyclical trend since the early 1990s to stock buy-backs during boom years (when managers get a share of profits through stock options) and less so during bust years (when profits and linked bonuses are falling).

<sup>21</sup>Part of the discrepancy may also be explained by holdings of foreign portfolio equity investments where the ownership share is below 10 per cent.



Another observation is that the financing for stock purchases appears to have been largely from borrowing not retained profits, and from sources other than banks.<sup>22</sup> Kliman and Williams (2014, p. 10) make a similar observation:

our findings indicate that corporations' increasing involvement in financial markets does not constitute a diversion of profit from production to finance, because the increases in financial acquisitions and payouts have essentially been funded by means of increases in borrowed funds.

Borrowing to meet interest and dividend payments connotes Ponzi-like financing relations. Borrowing to finance capital account transactions suggests, at least initially, that firms may be merely using greater leverage. The position of Kliman and Williams (2014) seems to be that greater recourse to borrowing explains why productive investment was not affected, in spite of higher financial payments, including stock repurchases.

The point must also be made that buying back ownership of the firm with borrowed funds can be conducive to accumulation objectives under certain conditions. If NFCs were to raise equity capital in order to pay down debt, many might view that strategy as prudent. The inverse of that liability-side substitution may be appropriate when debt liabilities are less expensive (and interest payments are tax deductible).

Usually, and from the perspective of firms, debt liabilities are considered to be riskier than equity liabilities as interest payments and principal repayments are obligated. A high proportion of short-term debt liabilities in the composition of total liabilities can expose a firm to the risks of refinancing on unfavourable terms or insolvency, even default. Nonetheless, if interest rates fall to a sufficiently low level (and acknowledging the type of amortisation matters) that may present managers with an opportunity to curb liability-side costs by substituting equity liabilities (and thus dividend payments) for debt liabilities (tax-deductible interest payments). Share buy-backs only bode for firm-level disaccumulation when financed out of profits that are not offset by net/new borrowing.

In repurchasing shares, managers will build a buffer against hostile takeovers, as well as appease the demands of impatient shareholders for capital gains. But the firm may also reap a financial gain from that strategy. Insofar as managers choose to meet the expectations of a high return on equity, it will be on a lesser volume of stocks outstanding (net of borrowing costs in the buy-back).

Managers are clearly aware of what markets consider to be an appropriate return on equity. The Governor of the Reserve Bank of Australia points to 'stickiness in the sorts of "hurdle rates" that decision makers expect investments to clear' (Stevens 2015) as part of the explanation for subdued business investment since the crisis. If managerial expectations of an acceptable return on equity are 'stickier' than lending rates, then swapping equity for debt could lower the hurdle to proceed with productive investments. Regardless, if impatient shareholders were forcing US NFCs to dis-accumulate through stock buy-backs, then that should also be evident outside US borders.

The liability-side of the MOFAs of US NFC parents, especially non-bank holding companies, is heavily-weighted towards equity (from parents and from hedge funds and

<sup>22</sup>There is a larger stock-flow discrepancy in US NFC unidentified miscellaneous liabilities during 1976–2014, but in the opposite direction to unidentified miscellaneous assets, equal to –\$4,319 billion. The discrepancy is mainly due to net equity issuance being –\$5,162 billion in the same period. In the flow of funds data there is no stock counterpart to stock repurchases as corporate equities are not considered to be a liability.

**Table 4.** US NFC MOFA stock items and direct investment, 2002–2012

\$US billion	US-inward NFC MOFAs			US-outward NFC MOFAs			Ratio (f)/(c)
	2002 (a)	2012 (b)	Change (b)– (a) = (c)	2002 (d)	2012 (e)	Change (e)–(d)=(f)	
Assets	2,286	4,290	2,004	4,420	13,371	8,952	4.5
Liabilities	1,546	2,796	1,250	2,171	5,259	3,088	2.5
Owners' equity	740	1,494	754	2,249	8,113	5,863	7.8
Direct inv. stock <sup>a</sup>	1,253	2,409	1,156	1,612	4,081	2,469	2.1

Source: US Federal Reserve (2015); BEAa (various years); BEAb (various years).

<sup>a</sup>Data is directional basis.

private equity groups). Negative net equity issuance is an unusual aspect of the contemporary era; however, it is also to be expected when tax systems encourage the use of debt over equity as interest payments are tax deductible while profits are subject to a comparatively high tax rate.

#### 4. Assessing the Rise of the American Supranational NFC

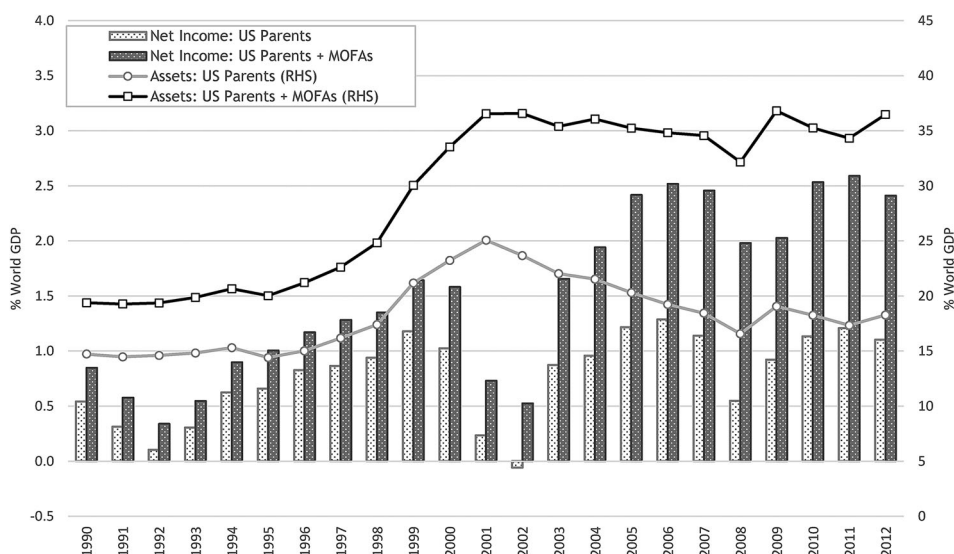
The scale of external activities of US NFCs has grown in importance over the last two decades. Some within the shareholder value discourse consider aspects of USDIA. For example, Duménil and Lévy (2004) include foreign earnings retained abroad as a component of US NFC financial income. They consider that the 'stock of capital is directly provided by the amount of USDIA in the assets of US non-financial corporations' (ibid, p. 94) from which they calculate a global profit rate. Putting to one side the nature of the said financial income, there are several reasons why it may no longer be as straightforward to interpret USDIA data.

Recall that Figure 3 shows a widening gap between the USDIA stock of NFC parents and the assets and owners' equity of US-outward NFC MOFAs. The growth in the assets of US-outward NFC MOFA over 2002–2012 exceeded that of the USDIA NFC stock by \$6,483 billion. Of the \$8,952 billion growth in the assets of US-outward NFC MOFAs during 2002–2012, around one-third was financed by an expansion in liabilities, presumably mainly debt, and two-thirds by equity (Table 4).

The scale of global activities by US NFCs is obviously much less if the analysis is restricted to direct investment data as per Duménil and Lévy (2004, 2011). In international investment statistics, the stock of direct investment is reported on a net directional basis between parents and affiliates, specifically as the sum of net inter-company debt plus the parent's share of the owners' equity of the affiliate.<sup>23</sup> The intent is to provide a net measure of funds that a parent places at the disposal of its affiliate (Locke *et al.* 2011). By analogy, USDIA is akin to reporting the financial statements of Wal-Mart, but only that which can be attributed to the Walton family's net directional financial stake in the corporation and only that of family members who are legal residents of a particular country.

Duménil and Lévy (2004, 2011) do not consider the US BEA's detailed financial and operating data for multinational enterprises (BEAb). Figure 9 provides an alternative perspective on the scale of US NFC external activities. It shows the assets and net income of

<sup>23</sup>The US BEA publishes three aggregate level measures of the direct investment stock: (1) directional basis at current-cost; (2) directional basis at market value; and (3) asset/liability basis. At present the only stock data that is published with sectoral disaggregation is the first methodology.



**Figure 9.** Assets and net income of US NFC parents and their MOFAs as percentage of world GDP, 1990–2012

Source: BEAb (various years); IMF (2015).

US NFC parents with affiliates, along with those of US-outward NFC MOFAs, as a proportion of world GDP. The surge in the assets of US NFC parents from the mid-1990s to 2001 mainly reflects a rise in the number of reporting parents.<sup>24</sup> Importantly, after 2001 the assets of US NFC parents start a downward trend while the combined assets of parents and MOFAs is steady. Such developments are contrary to Duménil and Lévy's (2011, p. 313) claim that 'the U.S. economy and U.S. capital in the world are comparatively shrinking. And the speed of this decline is faster than is often thought.'

Possibly, Duménil and Lévy might contend that USDIA is the relevant data to assess the global role of US NFCs, which would not be very convincing. Data reported on a net directional basis between parents and affiliates may say more about whether the affiliates are 'infant' or 'mature' (meaning more or less dependent on parent financing) than the comparative rise or decline of a nation's role in the global economy.

It is also increasingly difficult to identify where profits are generated on a geographical basis due to tax avoidance via transfer pricing (Heckemeyer and Overesch 2013) and tax minimisation schemes such as the channelling of income to affiliates in tax havens through royalty payments on patents. The methodology for reporting direct investment is not well-suited to the complex internal ownership structures of multinational corporations and the advent of corporations (as well as wealthy persons) becoming residents in tax havens.

<sup>24</sup>The number of US NFC parents with affiliates increased by one-third between 1994 and 1999, although part of that increase is a result of the 1999 BEA change in classification of sectors. The fall in the number of US NFC parents with affiliates from 2,079 in 1999 to 1,936 in 2004 to 1,753 in 2009 presumably reflects mergers and acquisitions rather than a retreat from the international sphere.

**Table 5.** Cumulative financial flows of USDIA and FDIUS, 1999–2014<sup>a</sup>

	Cumulative flows (\$US billion)				% of total cumulative flows		
	Total	Equity	Reinvested earnings	Inter-company debt	Equity	Reinvested earnings	Inter-company debt
USDIA NFC sector							
1999–2011	2,511	757	1,697	–7	30	68	0
2012–2014	910	42	840	29	5	92	3
FDIUS NFC sector							
1999–2011	1,908	1,356	257	125	71	13	7
2012–2014	444	188	235	21	42	53	5

Source: BEAc (various years).

<sup>a</sup>Financial flow data is without the current-cost adjustment and on a directional basis.**Table 6.** The activities of US MOFAs in tax havens, 2012

	\$US billion					
	Total assets	Net property, plant and equipment	Sales	Value added	Net income	Employees (1,000s)
Tax havens <sup>a</sup>	8,515	150	1,412	217	613	653
Other countries	13,088	1,134	4,546	1,203	449	11,463
Tax haven as % share of totals 2008–2012	39.7	11.4	23.3	14.6	59.5	5.6

Source: BEAb (various years).

<sup>a</sup>Ireland, Luxembourg, Netherlands, Switzerland, Singapore and other Western hemisphere (including Bahamas, Barbados, Bermuda, Netherlands Antilles and Caribbean).

#### 4.1 The Migration of US NFC Profits and Rich Household Wealth to Tax Havens

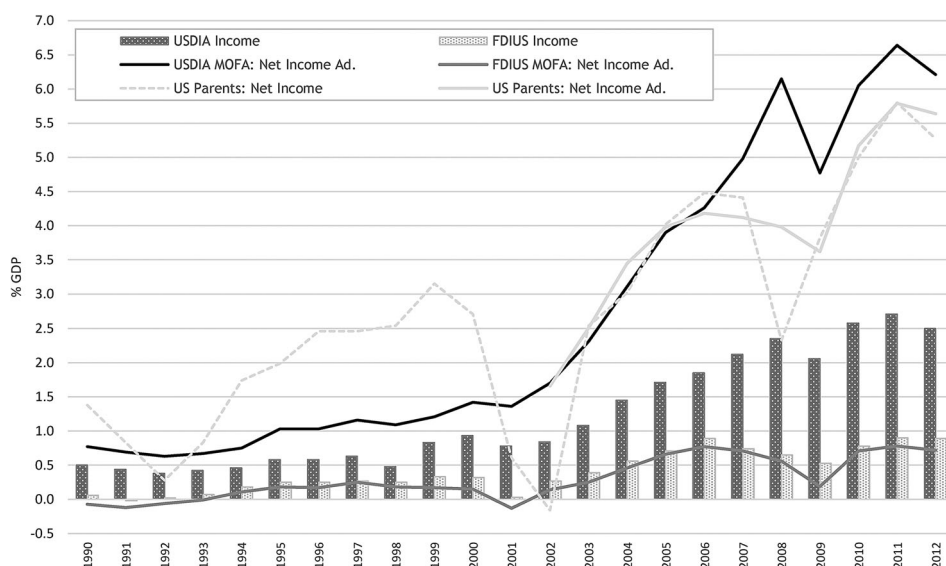
It is well known that tax considerations exert a major influence on the location of affiliates and the type of financing provided by parent companies. Notably, as US corporate taxes on foreign income can be deferred until repatriation, this creates an incentive for US parents to finance direct investment via reinvested earnings (Table 5).

Desai, Fritz Foley, and Hines (2006) find that US NFC parents with significant research and development operations and large volumes of intra-firm trade are more likely to establish affiliates in low-tax jurisdictions. Bosworth, Collins, and Chodorow-Reich (2007) report data showing that income shifting from domestic operations to tax havens raised USDIA receipts by 15 per cent over 1999–2004. Since then, the tax minimisation strategies used by several high-profile IT companies have become known.

It is now evident that US NFCs are using non-bank holding companies as conduits to shift profits from operations in any high-tax jurisdiction. Zucman (2014) estimates that two-thirds of the decline in the effective tax rate on US corporations from 30 to 20 per cent over the last 15 years is due to increased profit-shifting to tax havens. Google's filings show that in recent years it has paid an effective tax rate on foreign profits of 2–8 per cent.

Table 6 shows operating and balance sheet data for US-outward MOFAs in tax haven countries for all US parents.<sup>25</sup> During 2008–2012 the share of the tax-haven-MOFAs in the total assets and net income of all US-outward MOFAs was 39.7 per cent and 59.5

<sup>25</sup>The extent to which the MOFAs of US NFC parents are located in tax haven countries *vis-à-vis* that of US financial firm parents is not readily apparent as the data is not publicly available. The criterion for designating a country a tax haven is a comparatively high ratio of assets and/or net income to employees.



**Figure 10.** Direct investment income and net income of US NFC parents and US NFC MOFAs as percentage of US GDP (data by industry of parent), 1990–2012

\*USDIA and FDIUS income are reported on a directional basis.

Source: BEAa (various years); BEAb (various years); BEAc (various years).

per cent, respectively. Unbelievably, the tax-haven MOFAs employed only 5.6 per cent of the total MOFA workforce.

Unlike debt, which is not considered an indicator of direct investment ownership, the parent's ownership falls when an affiliate raises equity capital from non-parent sources. Since 2006, the net income of US-outward NFC MOFAs excluding capital gains (or losses) has been greater than that of US NFC parents (Figure 10). However, reflecting the falling ownership share of US NFC parents, the growth in MOFA net income has been more robust than that of USDIA income.

One factor in the falling ownership share of US NFC parents may be that the financing needs of affiliates evolve over time. As an infant affiliate requires time to develop its operations, not having a record of profitability, a parent may initially assume most of the financing risks. Over time a successful affiliate should shift its financing sources away from the parent's umbrella. The methodologies for reporting direct investment on the basis of the residence principle are therefore more suited to capturing cross-border positions of infant or unsuccessful affiliates.<sup>26</sup>

Another limitation is that direct investment data, like OECD tax systems, are not designed to deal with schemes like Google's 'double Irish Dutch sandwich' where most of the profits from Google's European activities are eventually shuffled to Google Holdings, an affiliate incorporated in Ireland and a resident of Bermuda, which has a corporate tax rate of zero. To the extent that a US parent's MOFA raises funds from investors, it may,

<sup>26</sup>Within the prism of direct investment data it is possible a parent could lend or inject funds into an affiliate, obtained from foreign residents, and yet the USDIA stock would increase. Alternatively, an affiliate could raise funds directly from US residents, and yet the USDIA stock would not increase. Direct investment data will at times provide arbitrary insights into the activities of multinational corporations.

**Table 7.** Assets of US parents and their MOFAs (\$US billion), 2012

	By industry of US parent		By industry of affiliate	Difference
	Parent	Affiliate	Affiliate	
<b>All industries</b>	30,942	21,603	21,603	0
<b>By industry of affiliate</b>	12,717	13,372	12,330	1,042
Manufacturing	6,613	9,934	2,403	<b>7,532</b>
Mining	603	493	902	–409
Wholesale trade	947	417	926	–509
Retail trade	605	493	255	238
Information	1,717	644	370	274
Professional, scientific and technical services	471	471	355	116
Other industries	1,762	919	7,119	–6,200
Management of non-bank companies and enterprises	(D)	124	6,340	<b>–6,217</b>
<b>Finance and insurance</b>	18,225	8,231	9,273	–1,042

Note: (D) = Data is suppressed.

Source: BEAb (various years).

in many circumstances, be effectively doing so albeit not legally in the parent's name. After all, many of these MOFAs produce the same products and services as the parent as well as utilise and develop the technology and intellectual property of the parent, or are simply shell companies to enable profit-shifting. The scale of external activities by a parent is only partially gauged by the funds it directly places at the disposal of its affiliates. Google and Google Holdings or Apple Inc. and Baldwin Holdings are examples where the distinction between parents and affiliates as separate entities becomes somewhat arbitrary in practice.

When investing internationally, US NFCs have taken to setting up non-bank holding companies (NBHC), which obscures the ultimate industry and ultimate recipient country of the investment. Manufacturing firms are behind the expanding role of NBHCs. The US BEA's (BEAb) financial and operating data classified by the industry of the affiliate show that US-outward MOFAs in manufacturing held assets worth \$2,403 billion in 2012 (Table 7). In contrast, data classified by the industry of the parent corporation listed the assets of US-outward MOFAs owned by US manufacturing parents at \$9,934 billion, which gives the impression that parent corporations were not utilising their manufacturing expertise when investing abroad. Most of the \$7,532 billion industry of parent/industry of affiliate discrepancy is readily explained when considering that, in 2012, the assets of US-outward MOFAs in the industry of NBHCs was \$124 billion for industry of parent and \$6,340 billion for industry of affiliate: a –\$6,217b discrepancy.

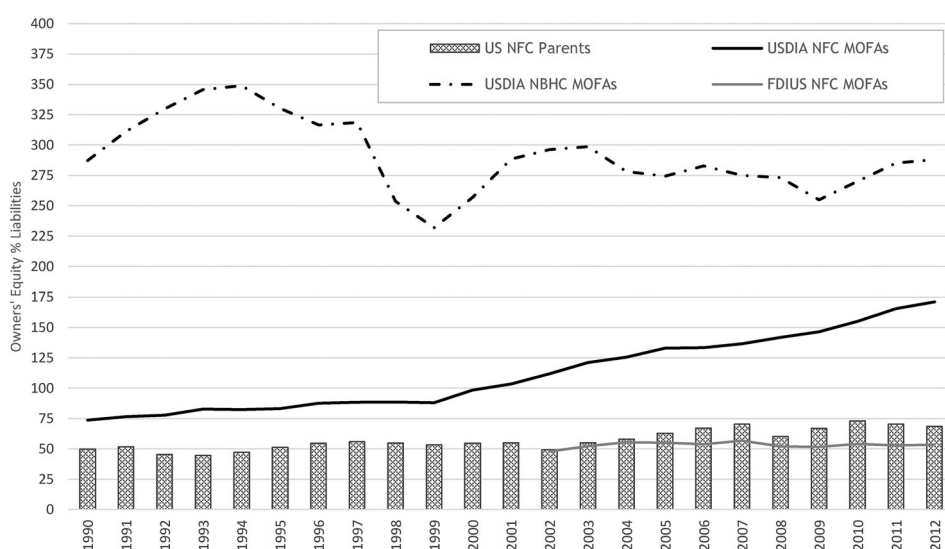
As there are significant negative parent/industry of affiliate discrepancies for the mining and wholesale trade industries as well as the financial sector, one can surmise that US manufacturing parents are likely to have expanded into those activities internationally as well. But the majority of the discrepancy must be in NBHCs which obscure the actual nature of investment by US manufacturing parents.<sup>27</sup> The role of NBHCs is substantial for USDIA but not FDIUS. NBHCs account for over 50 per cent of the assets,

<sup>27</sup>Seccareccia's (2012) observation that Canadian non-financial firms were investing substantially in derivatives is indicative to some extent of US national NFCs. At the same time, affiliate data classified 'by country and industry of affiliate' indicate US parent manufacturing activities in China and Mexico are minor, which is not plausible. A large portion of investment by US-outward NBHC MOFAs is likely to be in manufacturing.

**Table 8.** Activities of US-outward NBHC MOFAs (data by industry of affiliate), 1990–2012

NBHC % share of totals for NFC sector	Balance sheet			Income statement					Number of employees
	Assets	Liabilities	Owners' equity	Sales	Net income	Income from equity investment	Income taxes	Taxes other than income and payroll	
1990–1999	14.4	6.7	23.6	–	22.2	70.7	0.9	–	0.1
2000–2004	35.3	19.6	49.3	0.2	47.6	88.0	2.2	0.1	0.3
2005–2009	47.3	30.3	59.5	0.1	56.3	90.5	5.6	0.2	0.3
2010–2012	51.1	35.4	60.7	0.1	57.2	88.9	7.7	0.2	0.2

Source: BEAb (various years).

**Figure 11.** Owners' equity as percentage of other liabilities for US NFC parents and US NFC MOFAs (data by industry of affiliate), 1990–2012

Source: BEAa (various years); BEAb (various years).

owners' equity and net income of US-outward NFC MOFAs (Table 8). During 2010–2012 the share of NBHCs in the total for US-outward NFC MOFAs was 0.1 per cent for sales, 7.7 per cent for income taxes and 0.2 per cent for employees. Most of the income of US-outward NBHC MOFAs comes from equity investments in their own affiliates.<sup>28</sup> The NBHC layer obscures data interpretation. For example, if an analyst wanted to know the extent to which US-outward NFC MOFAs are exporting back to the US, there is no data for the affiliates of NBHCs.

As noted, US-outward NBHC MOFAs are funded primarily by equity instead of other liabilities (Figure 11). For the most recent benchmark year of 2009, two-thirds of the

<sup>28</sup>In 2009, 97.6 per cent of the investment by US-outward NBHC MOFAs qualified as direct investment in the recipient country.



owners' equity of US-outward NBHC MOFAs took the form of capital stock and one-third was reinvested earnings. Evidently there is ample equity financing available for US firms outside US borders.

An alternative explanation of the negative equity issuance by US NFC parents versus the very substantive growth in the owners' equity of US-outward NBHC MOFAs would underline the role of tax considerations in shaping managerial decisions regarding where to raise financing, what type (debt versus equity) and by which entity within the firm's ownership structure (parent versus affiliate). It would be costly for a US parent to raise equity and then inject funds into an affiliate. To receive the income streams and to distribute returns to its own shareholders, the parent would have to repatriate profits back to the US, and pay a tax rate of 35 per cent (excluding foreign income corporate taxes already paid). Just as US NFC parents prefer to keep profits offshore to minimise taxation, so too would many investors presumably prefer to receive their share of profits in a tax haven, particularly if they are residents for tax purposes (including hedge funds acting on the behalf of wealthy persons).<sup>29</sup>

Tax considerations provide an incentive for US NFC parents to raise equity financing outside of high-tax jurisdictions through their affiliates. Up until 2008 the US BEA published MOFA data for owners' equity by transactor (BEAb). The 0.1 per cent share in the owners' equity excluding retained earnings of US-outward NFC MOFAs, reported for all 'other US persons', does not seem credible. Zucman (2013) estimates that 8 per cent of global household wealth is held in tax havens, of which three-quarters goes unreported. According to Zucman (*ibid*, pp. 1324, 1341, 1347):

households own a large amount of mutual fund shares through unrecorded accounts in tax havens ... Each year, more than 10% of all cross-border equities and bonds have unknown owners. Twenty percent of all cross-border equities and fund shares have no identifiable owners ... Overall, claims on funds incorporated in Luxembourg, Ireland, and the Caymans account for 48% of the globally missing wealth.

Some portion of the unreported wealth ends up financing the NBHCs of US NFC parents. Zucman's (2013) study only considers wealthy agents who reside outside tax havens, not those who reside in tax havens. Even if a large share of the world's wealth was not missing from international statistics, it is reasonable to think of wealth in the Caribbean islands as predominately US capital. Wealth held in tax havens like Luxembourg and Switzerland may be largely European capital albeit with substantial American representation. The only logical conclusion is that interpreting data based on the residence principle is increasingly difficult when corporations and rich individuals are, overtly and through non-disclosure, migrating their financial wealth to tax havens.

## 5. Conclusion

This article has sought to delineate the activities of NFCs. One finding is that the extent of external activities by US national NFCs is very strongly obscured in direct investment data. The expansion of US national NFCs into traditional and non-traditional activities abroad suggests the managerial preference for growth is not that different to the 'Galbraithian firm'.

<sup>29</sup>In 2013, around 9 per cent of US-listed equities were held by investors in tax havens compared to 2 per cent in 1990 (Zucman 2014, p. 137).

A difference from the early-post Second World War era is that rising CEO power has come with a manager-friendly pay regime paid for at the expense of 'ordinary labour'. US NFC MOFAs exporting back to US markets intensifies the income squeeze by undermining job conditions in US export and import-competing industries. The combination of large trade deficits and sluggish firm investment in the US find a stark and interrelated contrast in large trade surpluses and a high investment share of output in developing Asia.

By considering direct investment as a financial asset, the financialisation explanation of contemporary macro patterns is overstated. Further research is needed to unmask the activities of NBHC MOFAs, including the identification of the countries and industries in which they ultimately generate their income. With US NFCs retaining profits abroad and setting up shell companies to avoid income taxes, it is reasonable to expect an increase in short-term financial investments. NBHCs are also likely to be conduits for productive investment as well as income-shifting and merger and acquisition activity. The international sphere complicates an interpretation of domestic US corporate data. It is clear, however, that US national NFCs now have a strong preference for external accumulation and have forsaken a sense of nationalism for a 'home' in tax havens.<sup>30</sup> The captains of US industry may thus be making investment decisions which are not conducive to a process of expanded reproduction.

Euthanasia of the rentier and a somewhat comprehensive socialisation of investment were two of Keynes' (1936) radical suggestions with which he concluded *The General Theory of Employment, Interest, and Money*. With a financialisation lens, the first seems not only imperative but also sufficient to enable a revival of industry. In this vein, Duménil and Lévy (2011) believe the contradictions of shareholder value orientation are so great that it may usher in a new era of capitalism based on strengthened managerial leadership. They also anticipate that a 'concern for the preservation of US hegemony' will play a crucial role (p. 295).

My contention is less optimistic, as nationalism and the rise of CEO power do not necessarily fit together. In the US, managers have generously rewarded themselves in monetary terms and with stock options. Of the \$21–32 trillion held in tax havens by the high net worth individuals, it can be said that the managerial class is likely to be well-represented and the international tax regime is broken (Henry 2012).

## Disclosure statement

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<sup>30</sup>Microsoft stated as much in its 2014 filing that it is no longer recognising deferred US income taxes on earnings of foreign subsidiaries worth \$92.9 billion as the funds are 'permanently reinvested outside the U.S.' (Zucman 2014).

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