Forbes

American Compass Points To Myths Not Facts

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June 27, 2023

After reading the *Financialization* chapter of its new policy handbook, Rebuilding American Capitalism, it's easier than ever to ignore American Compass. Still, rather than ignore it, I hope conservatives – the handbook's target audience – pay very close attention to the report's low quality of scholarship.

The report is poorly reasoned and, as with previous American Compass publications, it fails to provide proper support for most of its key claims. It is tempting to excuse this shortcoming as driven by American Compass' effort to reach a wider audience with soundbites. But their opinion-style propaganda is born out of necessity: They must leave out supporting research and data because it doesn't exist.

Just as the data soundly contradicts their income stagnation thesis, nothing really supports American Compass' claim that "financialization is a blight on capitalism."

The report doesn't even offer a coherent definition of financialization, leaving it with little more than scary-sounding phrases. It does complain that financialization diverts "resources away from capital intensive projects and toward financial assets," whatever that means. Later, though, it claims that this resource diversion is both "*one* definition" and "the most pernicious *effect*" of financialization. (Emphasis added.)

Definitional issues aside, the report claims that in recent decades, "American finance has metastasized, claiming a disproportionate share of the nation's top business talent and the economy's profits, even as actual investment has declined." It provides no supporting evidence whatsoever for these claims, and it's not difficult to figure out why – the evidence simply doesn't support them.

For instance, government data shows the number of people employed in the *Finance and Insurance* industry, as a share of total nonfarm employees, has barely budged from 4.5 percent since 1990. It turns out that financial industry employment didn't even vary much when interest rates started falling in the 1990s. And although these figures are not strictly comparable, 1970 Census data reports a slightly *higher* share of total employment for the finance industry in 1970.

It's impossible to know exactly what American Compass means by *profits* because they don't cite anything, but the National Income and Product Accounts provide financial and nonfinancial company profits dating back to 1998. (See Table 6.16D, Corporate Profits by Industry.) While the annual share of total corporate profits in the NIPAs has varied, at the end of 2022 it was 18 percent for financial companies versus 82 percent for nonfinancial companies. In 1998 the share for financial firms was a touch *higher* (20 percent) compared to nonfinancial firms (80 percent).

The claim that *investment* has declined is also easily verified as false.

For instance, the NIPAs show that investment in fixed assets has been steadily *increasing* since 1970, a trend that holds even if the data is adjusted for inflation. (See Table 1.5, Investment in Fixed Assets and Consumer Durable Goods.) If American Compass insists on going with some other definition of investment, something like *real net investment in the nonfinancial corporate sector*, the evidence still isn't in their favor. They also have a similar problem if they want to use some kind of generalized "investment in manufacturing" definition.

It gets worse.

For example, the report portrays the Silicon Valley Bank failure as some sort of apocalyptic sign of "imbalances facing the U.S. economy as a whole." (See page 61.) It claims that typical banks "happily make more loans" when their deposit base grows, but SVB's clients were "poor candidates for conventional bank lending." As such, SVB "essentially turned to speculating on interest rates" because it was faced with "limited appetite from its customer base for conventional loans."

The main problem here is that a quick check of SVB's financials shows that the bank's loans were growing right along with its deposits. From 2013 to 2022, their average annual loan growth was 24 percent. (These are my own calculations from SVB's individual annual reports.)

Moreover, loans as a percentage of total assets were not radically different at SVB than other large banks such as Citi and JP Morgan, banks with "typical" deposit bases. In 2021, for example, the percentages were 31 percent, 29 percent, and 29 percent, for SVB, Citi, and JP Morgan, respectively. (These are also my calculations from the banks' annual reports.)

The report also repeats the common progressive talking point that private equity (PE) and leveraged buyouts (LBOs) produce too much speculative debt at the expense of some third party, such as workers. But it ignores the contradictory evidence that PE firms lead to higher levels of optimal debt in companies, and that high levels of debt in these situations tends to improve company performance. It also ignores evidence that PE firms played a *stabilizing* role in financial markets during the 2008 financial crisis and the COVID-19 crisis by drawing in capital to keep companies running.

I could go on and on, but there's really no point. American Compass is in the business of popularizing myths, not facts.