From exit to control: The structural power of finance under asset manager capitalism

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Abstract

Political economists have theorized the structural power of finance as a function of the scarcity of financial capital, which empowers its owners and intermediaries to (threaten) exit. This theory has trouble explaining the non-death of the rentier at a time when financial capital is abundant and lacks a credible exit option. This paper presents a theory updated for a world characterized by financial capital abundance, and by a shift in the predominant function of finance from banking to asset management. Today, asset managers pool financial capital on a scale that often puts them in a position of (near) control, while also maintaining a high degree of portfolio diversification. This defining feature of asset manager capitalism, although observable across asset classes, is most pronounced in the corporate economy. Whereas the control-based dominance of finance capital during the early 20th century was characterized by credit-debt relationships between banks and corporations, today asset managers' equity holdings dominate; and whereas the shareholder capitalism of the late 20th century was characterized by impatient investors wielding the threat of exit, the power of asset managers in corporate governance is based on their large and illiquid, yet fully diversified shareholdings. Theorizing the structural power of finance as based on control and diversification helps explain both the rentier's longevity and asset managers' contribution to that outcome.

Keywords: Financialization, finance capital, rate of return on capital, rentier, shareholder value, corporate governance

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> I feel sure that the demand for capital is strictly limited in the sense that it would not be difficult to increase the stock of capital up to a point where its marginal efficiency had fallen to a very low figure. … [I]t would mean the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital.
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> Keynes 2018 [1936], p. 334.

Introduction

Since the 1970s, the financial sector has greatly increased in size. At the same time, the owners and intermediaries of financial capital have become more powerful vis-à-vis other sectors and the state. The political economy literature sees these trends as two sides of the same coin. This view rests on a theory that assumes financial capital to be scarce and that conceptualizes the financial sector as providing scarce financing. From this perspective, the structural power of finance is a function of its ability to threaten to *exit* firms, sectors, or entire countries. This logic is epitomized by the figure of the "impatient" institutional investor that, in the 1990s, came to dominate corporate governance in the United States and the UK (Harmes, 1998). Although sound in principle, this exit-based theory of structural power runs into trouble at a time when all indicators point towards financial capital having become abundant. What political economists have treated as two aspects of the same trend actually constitutes a major puzzle – if creditor exit is a lesser threat because financial capital has not been scarce, then why should the structural power of finance persist, let alone increase? Keynes, too, would be surprised to learn that even though his prediction that the "marginal efficiency" of financial capital should fall "to a very low figure" has been borne out, rentiers are alive and kicking.[1]

This paper presents a different account of the growth of finance and, more importantly, an alternative theory of the structural power of wealth owners and their financial intermediaries. Scholarship in political economy and economic sociology tends to overstate the puzzle of the growth of finance since the 1970s, failing to appreciate just how exceptional the financial repression of the Bretton-Woods period was. By contrast, from the vantage point of the historical literature on capitalism in the *longue durée* –

[1] For a discussion of the developments Keynes' prediction of the euthanasia of the rentier failed to anticipate, see Christophers (2020, pp. 64–84). See also Mazzucato (2018).

key authors are Braudel, Arrighi, and van Bavel – there was nothing surprising about the regime shift from a high-growth economy in which investment opportunities were abundant but financial capital was scarce, to a low-growth economy in which investment opportunities are scarce but financial capital is abundant. Indeed, from a historical perspective, the growth of finance is overdetermined by the need to manage and invest wealth accumulated over extended periods of time (i.e., corporate profits not reinvested and household income not spent). What *does* constitute a puzzle even from a historical perspective, however, is the growth and persistence of financial-sector power during this most recent period of financial expansion. If financial-sector size is a function of relative financial capital abundance, then how do wealth owners and their financial intermediaries achieve satisfying rates of return on financial capital?

My central argument is that finance capital is back, and that financial-sector power is increasingly based not on financing and exit but on (diversified) ownership and control, exercised by asset management companies. The argument has a structural and an agential component. Structurally, the financial system is shape-shifting, over the course of long economic cycles, between the functions of financing and wealth preservation. During periods of economic dynamism and growth – think late 19th-century United States or post-World War II Europe – financial intermediation is driven by demand for financial capital from the non-financial sector. By contrast, during periods of relative financial capital abundance, financial intermediation is driven by savers in search of scarce investment opportunities. Depending on which of these structural conditions prevails, different types of financial intermediaries dominate the scene. Under conditions of financial capital scarcity, the dominant intermediaries are banks. By contrast, under conditions of financial capital abundance, the dominant financial institutions are asset managers – financial firms that pool and invest "other people's money." I will refer to the resulting configuration as "asset manager capitalism". As a corporate governance regime, asset manager capitalism is at its most developed in the U.S. corporate sector, but its footprint is growing in other countries and other asset classes (Braun, 2021).

My primary target is the literature on the political economy of finance and capitalism. However, the paper also holds insights for the broader literature on wealth and wealth inequality. Sociologists of class and inequality have been calling for a return to the study

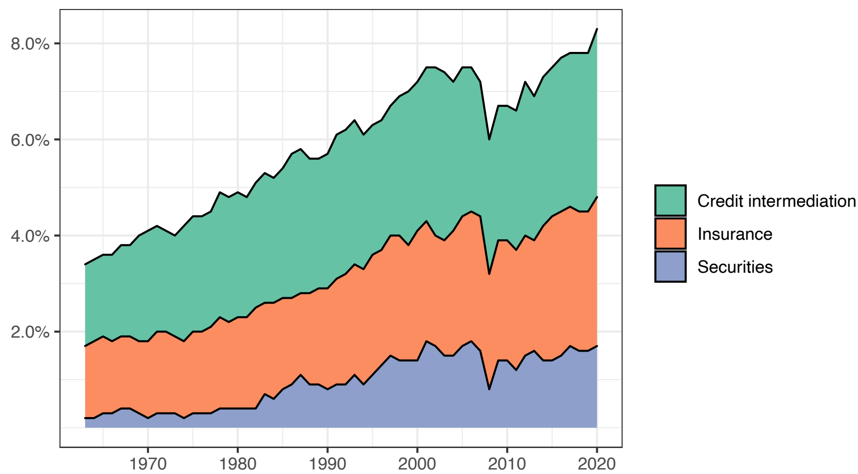
of (wealth) elites, and in particular of the mechanisms through which these elites gain and perpetuate their wealth (Beckert, forthc.; Savage, 2021), and recent empirical work has shed much-needed light on household wealth and its composition (Goldstein & Tian, 2020; Hansen & Toft, 2021; Pfeffer & Waitkus, 2021). However, this literature has barely broached the question of the single most important determinant of top-1% wealth – the rate of return on capital. Not only has this rate remained stubbornly high in the aggregate (Jordà et al., 2019; Piketty, 2014), there is also overwhelming evidence for the "Matthew effect", whereby those households with the highest net wealth achieve the highest rates of return (Bach et al., 2020; Ederer et al., 2020). To date, most explanations of how wealthy rentiers avoid the fate predicted by Keynes have focused on their use of the tax-evading or tax-minimizing offerings of the offshore world (Alstadsæter et al., 2019; Seabrooke & Wigan, forthc.). By contrast, scholars have paid less attention to the "investment chain" – the institutions and practices through which the wealthy invest and earn returns (Arjaliès et al., 2017; Harrington, 2016). Here, the emergence and consolidation of the asset management sector, and its sub-division into firms specializing in various "alternative" or "private" asset classes, have been game-changing developments. Whatever rate of return achieved by the wealthy, attempts to explain it need to put front and center the intermediaries who do the investing and who exercise structural power on their behalf – both vis-à-vis the issuers of financial instruments and vis-à-vis regulators and tax authorities.

The paper proceeds as follows. The next section places financialization in its historical context and, drawing on the work of Braudel and Arrighi in particular, emphasizes is tendency to recur towards the end of long cycles of capital accumulation. Section two adds a macroeconomic perspective and presents descriptive quantitative data in support of the financial capital abundance view. Section three sketches a theory of structural financial-sector power under conditions of financial capital abundance centered on the concepts of control and diversification. Section four illustrates that theory by tracing the return of control and the perfection of diversification in the US shareholder structure – that is, the rise of asset manager capitalism as a corporate governance regime. The final section concludes.

1. History: Financialization in the longue durée

Figure 1 reproduces and updates one of the iconic charts of the financialization literature, showing the value-added share of GDP of the three segments of the US financial sector since 1963. Whereas credit intermediation (i.e., banking) and insurance have doubled their share, the share of the securities segment (i.e., investment banking and asset management) has increased more than eightfold. What explains this explosive growth? And what should we expect to be its consequences? Our answers to these questions depend on how much history and macroeconomics we bring into to the analysis.

Figure 1: Financial services, value added share of US GDP, 1963-2020



Data: Bureau of Economic Analysis (BEA).

The historical horizons of scholarly writings on financialization range from five decades to five centuries. The political economy literature arguably falls on the short end of that spectrum (Koddenbrock et al., 2020). Political scientists and sociologists perceived the explosive growth of finance as a shift from the mixed economy of the post-World War II decades, characterized by Fordist production regimes, social democratic welfare states, and financial repression. In order to explain this shift, the financialization literature has studied the regulatory and monetary policies that enabled financial-sector growth since the 1960s (Krippner, 2011). Although her work was foundational for this research agenda, Greta Krippner is not to blame – she was clear that financialization, rather than a "novel phase of capitalism", should be seen as "a recurring phase in the evolution of capitalist economies"(Krippner, 2005, p. 199).

Both Marxists and post-Keynesians have taken a longer view, emphasizing the parallels between late 20th-century financialization and late 19th century "finance capital" (Chesnais, 2016; Palley, 2016; Windolf, 2005). Here, the primary source is Rudolf Hilferding, for whom finance capital represented the outcome of an extended period of capitalist accumulation, during which a "steadily increasing proportion of capital in industry does not belong to the industrialists who employ it" but instead belongs to the banking sector, which in turn "is forced to keep an increasing share of its funds engaged in industry." This "capital in money form which is … transformed into industrial capital" is what Hilferding called finance capital (Hilferding, 1985, p. 283). The hallmarks of finance capitalism were the dominance of the financial sector – as opposed to states, families or individuals – among the creditors and shareholders of corporations; and the high degree of control the financial sector exercised in corporate governance – the "unity of ownership and control … within the strategic centre of the circulation of interest-bearing capital" (Harvey, 2006, p. 317). Although historians of the US (and German) corporate governance regimes around 1900 tend to come to more nuanced conclusions about the power of "Morgan's men" (DeLong, 1991; Fohlin, 2007; O'Sullivan, 2016), Hilferding's overall analysis of finance capital stands.

While Hilferding significantly expands the historical horizon of financialization scholarship, the longest timeline emerges from Fernand Braudel's work on the *longue durée* of capitalism. Writing in the 1970s, Braudel insisted that "[f]inance capitalism was no newborn child of the 1900s." Instead, he conceptualized financialization – without, of course, using the term – as a cyclical phenomenon, that occurred whenever "a wave of growth in commercial capitalism" led to the "accumulation of capital on a scale *beyond the normal channels for investment.*" Unable or unwilling to reinvest profits in their enterprises, wealth owners shift capital into financial assets. The resulting growth of the financial sector allows the latter "to take over and dominate, for a while at least, all the activities of the business world"(Braudel, 1984, p. 604). This theory of financialization as a stage recurring towards the end of long cycles of capitalist (over-)accumulation was further developed by Giovanni Arrighi (1994). Focusing on the Genoese, Dutch, British, and US cycles of accumulation, Arrighi added a theory of hegemonic transition, whereby the retreat of capital from commercial or industrial enterprise into financial assets

invariably contributes to the financing of the rising hegemon. The argument that financial expansion represents an endogenous consequence of capitalist accumulation that generally indicates an institutional and economic weakening of the underlying growth regime – in Braudel's phrase, a "sign of autumn"(Braudel, 1984, p. 246) – has recently found further support in van Bavel's (2016) work on the rise and fall of market societies.

A historicized understanding of the phenomenon thus recasts financialization as a normal – as opposed to pathological – phase of capitalist development. More importantly still, it shifts our attention from the question of financial sector *size* – which fluctuates over the course of cycles of accumulation – to the question of what determines the structural power of wealth owners and their financial intermediaries, as measured by their ability to achieve (satisfying) returns on their invested capital. Throughout financial history, this power hinges on the extent to which financial instruments and infrastructures allow investors to achieve *control* and *diversification*.

The question of control concerns the relationship between finance capital and the "real" economy. When capitalists shift capital accumulated from commercial or industrial activity into financial assets, that capital does not disappear from the real economy – a point of some confusion in the recent financialization literature. In order for those wealth owners to earn a return, financial intermediaries must find profitable investments, which invariably requires lending to, or investing in, risky, real-economy endeavors. Whether the borrowers are warring states – as in the cases of Genoese, Venetian, and Dutch bankers lending to Spanish, Dutch, and British sovereigns, respectively – or private businesses – as in the case of British bankers investing in US railroad bonds – these investments force financial-sector creditors to devise techniques to control the policies and activities of non-financial borrowers.

The second, closely related issue concerns wealth owners' ability to achieve a return on that share of their wealth that is invested via financial channels. Besides many other variables, this rate of return is a function both of the degree of portfolio diversification and of the ability of financial intermediaries to exercise control over debtors. Here, a key theme of financial history is the steady expansion of the universe of financial intermediaries, instruments, and infrastructures available to owners of financial wealth. Genoese wealth owners and their bankers no doubt benefitted from bankrolling the

Spanish crown, but their dependence on extending non-tradable loans to this fiscally unreliable "borrower from hell" certainly limited their structural power (Drelichman & Voth, 2011). By contrast, in late 19th-century Britain, landed gentry and industrialists in search of financial investment opportunities were in a much better position. Not only could they choose between government debt and domestic equities – they could easily gain exposure to a broad range of foreign bonds and securities by buying shares issued by the Foreign & Colonial Investment Trust, the world's "first global emerging markets investor" (Chambers & Esteves, 2014). Three centuries of financial innovation had greatly improved the intermediaries, instruments, and infrastructures of financial capital. This development has since continued, further enhancing the asset management sector's ability to combine diversification and control.

Through much of economic history, the financial sector played only a minor role in determining the rate of return on capital – for the simple reason that assets were not securitized, and that financial assets accounted for only a small share of the asset portfolios of the rich. By contrast, the hallmark of asset manager capitalism is precisely that asset managers – supported by a broader "wealth defence industry" of lawyers and accountants (Ajdacic et al., 2020; Pistor, 2019; Winters, 2017) – constantly reorganize economic activity so as to better serve the remuneration of finance capital. Indeed, under conditions of financial capital abundance, finance operates not so much as "a system for the allocation of resources" than as "a weapon by which the claims of wealth holders are asserted against the rest of society" (Jayadev et al., 2018, p. 360).

How this weapon is wielded varies across time and space. During the 1980s and 1990s, financialization along the *intensive margin* prevailed, namely in the form of the shareholder value revolution, which was geared towards increasing the "rentier share" of corporate profits (Henwood, 1997, p. 73). In the sphere of publicly listed corporations, this "corporate financialization regime Mark I" has given way to a "Mark II" regime, under which powerful asset managers keep the rentier share high, while various forces push the corporate economy towards monopolistic market structures organized around intellectual property rights (Auvray et al., 2021; Schwartz, 2021). The most important shift, however, has occurred outside the realm of listed corporations, where financialization along the *extensive margin* has greatly accelerated. Through processes of

"capitalization", "assetization", or "securitization", extensive-margin financialization renders new areas of economic activity amenable to financial investment (Birch & Muniesa, 2020; Langley, 2020; Leyshon & Thrift, 2007; Nitzan & Bichler, 2009). Alternative asset managers have been in the vanguard of this process, turning unlisted corporate equity (Benquet & Bourgeron, 2021; Eaton, 2020), residential real estate (Christophers, 2021a, 2021b), infrastructure (Gabor, 2021), and even farm land (Ouma, 2020) into asset classes accessible to institutional capital pools. Such extensive-margin financialization is both a consequence of and a condition for widening wealth inequality, which increases the supply of financial wealth in search of the liquid yet diversified investments that only financial assets can provide.

2. Macroeconomic perspectives on financial capital abundance

Although Greta Krippner emphasized aggregate demand deficiency as the macroeconomic problem that financial deregulation sought to address, the subsequent literature has largely neglected the macroeconomic dimension of financialization. Instead, the literature has tended to break financialization down into its sectoral components, studying how households, corporations, and states turn to finance for investment and/or borrowing purposes;[2] and to document the income- and wealth-inequality increasing effects of these financialization processes (Godechot, 2016; Huber et al., 2020; Lin & Tomaskovic-Devey, 2013). From a macroeconomic perspective, there are two main problems with this approach.[3] The first, and by now well documented, problem is that a more sophisticated disaggregation of corporate balance sheets leads to a rejection of the corporate financialization hypothesis – financial speculation has not become a major source of corporate profits.[4] Secondly, and more importantly, the focus on non-financial

[2] The literature comprises studies on corporate financialization (L. E. Davis, 2016; Karwowski, 2018; Klinge et al., 2021), household financialization (Chwieroth & Walter, 2019; Goldstein & Tian, 2020; Pagliari et al., 2020), and state financialization (Hardie, 2012; Schwan et al., 2020).

[3] For a broader critique of the concept of financialization, see (Christophers, 2015).

[4] This result is obtained when the analysis of financial *assets* distinguishes between financial assets proper and (often offshoring-related) foreign direct investment; and when the analysis of financial *income* focuses on net – rather than gross – financial income (Fiebiger, 2016; Rabinovich, 2019).

actors' demand for credit obfuscates the fundamental importance of the *supply* of financial capital. The growth of finance reflects not (only) the increased demand for credit but the accumulation of institutional pools of financial capital that needs to be intermediated by banks, insurers, and asset managers. Thus, from a macroeconomic perspective, the growth of finance since the 1970s has been causally overdetermined. In the words of three eminent financial economists, "[f]inance *should* grow as an economy matures, because the preservation of wealth is an increasingly important function of the financial system" (Gennaioli et al., 2014, p. 1253).[5]

In order to makes sense of financial capital abundance, engaging with macroeconomics is essential, but not without pitfalls. Neoclassical theory, as well as much work in economic history, conceptualize capital as a physical stock, while abstracting from money and finance (Levy, 2017). Piketty himself gets into some murky waters because his "Marshallian apparatus" sees capital "more as a stock of accumulated savings rather than a claim on future output" (Naidu, 2017, p. 100). As critics have pointed out, this conception leads Piketty to attribute increased wealth-to-income ratios to investment-driven physical capital accumulation, rather than to increased asset valuations, notably of the residential housing stock (Rognlie, 2016). The attribution error is significant, for the asset valuation view implies that the increase in wealth-to-income ratios since the late 1970s is actually the result of "an unduly *low* rate of investment in real capital" (Rowthorn, 2014, p. 1282; emphasis added).[6] This critique is consistent with the Braudel-Arrighi view of financial capital abundance as resulting from the exhaustion of a previously successful growth regime.

Despite the absence of money from their models, mainstream macroeconomists have increased their efforts to conceptualize financial capital abundance. Bernanke's "savings glut" conceptualizes financial capital abundance in the US as the result of excess savings

[5] What is more, since wealth accumulation occurs at the global level, whereas financial intermediation tends to be concentrated in a few global financial centers, the size of the latter – including, first and foremost, US finance – is also a function of wealth accumulation and financial deregulation in the rest of the world, which has greatly increased (Oatley & Petrova, 2020).

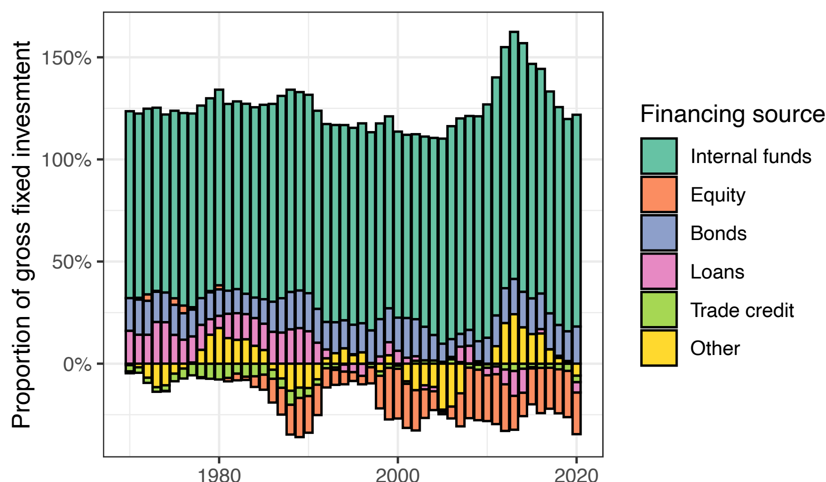
[6] Large valuation increases require that economic assets or activities are "capitalized", so as to be amenable to financial investment. Capitalizing things is what finance does under conditions of financial capital abundance. On the history of capitalization in the United States, see Cook (2017).

in the rest of the world, especially in the export-driven Northern European and East Asian economies (Bernanke, 2005; Klein & Pettis, 2020). Summers' (2014) revival of the idea of a "secular stagnation" has diagnosed structurally deficient aggregate demand as the root cause of the problem, combined with the difficulty for real interest rates to fall to a sufficiently negative level. Caballero, Farhi, and Gourinchas (2017) have postulated a "safe asset shortage", whereby the demand from investors with a preference for safety over yield outstrips the rate at which states (and other actors) issue high-quality bonds (see also Ahnert & Perotti, 2021). Mian, Straub, and Sufi (2021) have argued that the due to wealthy households' higher propensity to save, increasing inequality has been the lead cause of the decline in the (unobservable) natural rate of interest.

Beyond such attempts to formalize the idea of financial capital abundance within the framework of mainstream macroeconomics, direct quantitative evidence of capital abundance is difficult to come by. The most prominent indicator is the real rate of return for safe assets, which has followed a downward trend since the 1970s. A more direct measure of capital abundance is the extent to which the non-financial corporate sector's capital formation is financed by external funds. Figure 2 shows results obtained by using the methodology proposed by Corbett and Jenkins (1997) and further explained by van Treeck (2009). It shows, first, that the vast majority of corporate investment is financed from internal funds, that is, retained profits. Second, while the stock market had not been a source of net financing for the corporate sector since 1970, its contribution turned negative in the 1980s, meaning the stock market has helped ferret capital *out* of the corporate sector (Henwood, 1997; Mason, 2015), at the expense of workers and investment (L. E. Davis, 2018; Palladino, 2020). Third, and most remarkably, even traditional loans have made a negative contribution since 1990.[7]

[7] Note that these findings do not contradict the observations that aggregate corporate debt levels are high in the US (Baines & Hager, 2021; L. E. Davis, 2016), and that corporate saving has trended upward globally (Chen et al., 2017; Redeker, 2021).

Figure 2: Financing of gross fixed investment, US non-financial corporations, 1970-2021

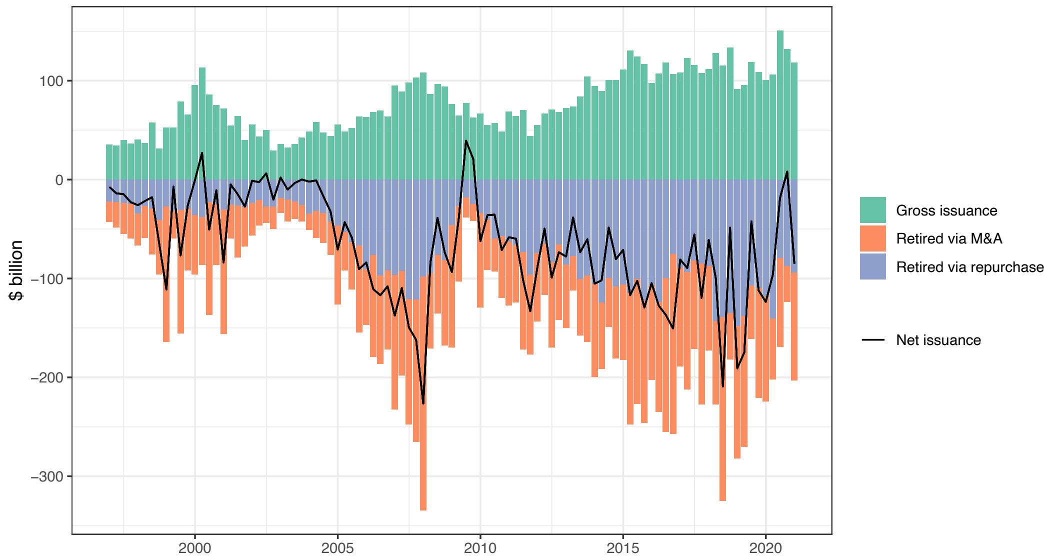


Source: Federal Reserve, US Financial Accounts.

Note: Author's calculations based on Corbett and Jenkins (1997) and van Treeck (2009). Sums do not add up to 100% due to the approximate nature of both the method and the underlying data.

We can drill down further by taking a closer look at the equity and loan categories. Figure 3 shows why net issuance of corporate equity in the US has been negative since 1996. Although gross issuance has followed an upward trend, that growth has – until the beginning of the Covid-19 pandemic – been eclipsed by the retiring of shares via stock buybacks and mergers and acquisitions. Therefore, to the extent the US stock market has absorbed any new capital, it has done so via higher valuations (Kuvshinov & Zimmermann, 2020). Lending to non-financial corporations has also turned negative. Since the category "loans" also includes government loans and loans from non-bank financial institutions, shedding light on *bank* lending to non-financial corporations requires data on commercial bank assets, displayed in Figure 4. We see that commercial and industrial loans (brown) have seen the largest decline in total bank assets, whereas real estate loans (orange) have seen the largest increase. At the same time, loans to non-depository financial institutions, such as private equity and hedge funds (not shown in Figure 4), have more than doubled in absolute terms since 2015. This "debt shift" from business lending to mortgage lending and intra-finance lending has been theorized and documented for a large number of countries (Bezemer et al., 2020; Jordà et al., 2016).

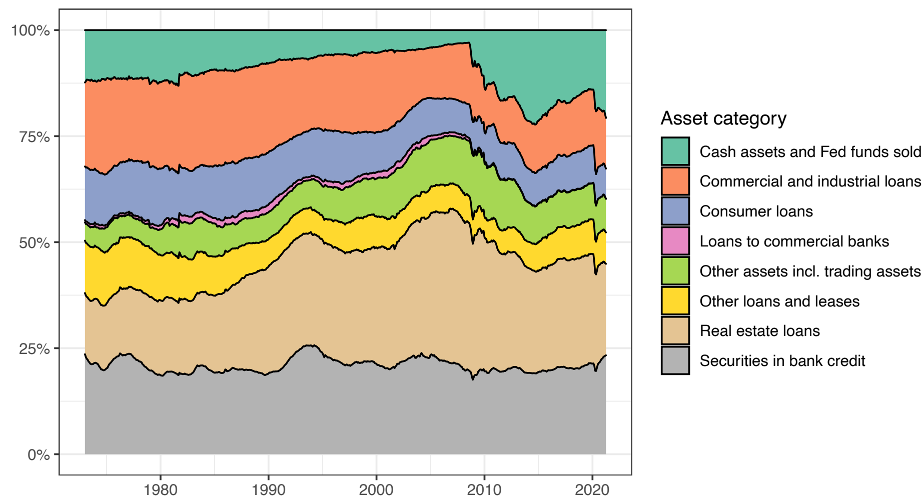
Figure 3: Net corporate equity issuance, United States, 1996-2020



Data: Federal Reserve, US Financial Accounts.

The declining demand of the corporate sector for financial capital has coincided with an explosion both of institutional capital pools and of the financial sector's capacity for credit creation, or leverage (Bezemer, 2014; Gabor, 2016; Sgambati, 2019). In the absence of Schumpeterian entrepreneurs willing to borrow, the financial sector has increasingly focused on capitalizing new asset classes. Thus, financial capital has moved into "private" – that is, not publicly listed – or "alternative" assets. As their assets under management have increased from near zero in 1970 to $2.4 trillion in 2010, and to $4.1 trillion today (McKinsey, 2021), firms specializing in private capital have expanded their activities. In the corporate sector, private equity firms have complemented the traditional buy–one–firm–and–restructure strategy with a buy–many–firms–and–merge strategy (Eaton, 2020). Since the global financial crisis, private equity conglomerates such as Blackstone have also moved into housing on a massive scale (Christophers, 2021a, 2021b). Although real estate continues reigns supreme in the "asset economy"(Adkins et al., 2020; Ansell, 2019), the petit rentier class has been shrinking in most countries (Goldstein & Tian, 2020), whereas the asset manager-driven financialization has transformed residential real estate into an asset class accessible to institutional capital pools (Wijburg et al., 2018).

Figure 4: Assets held by US commercial banks, 1973-2021



Data: Federal Reserve, US Financial Accounts, H8, Table 2.

Note: Includes US branches and agencies of foreign banks.

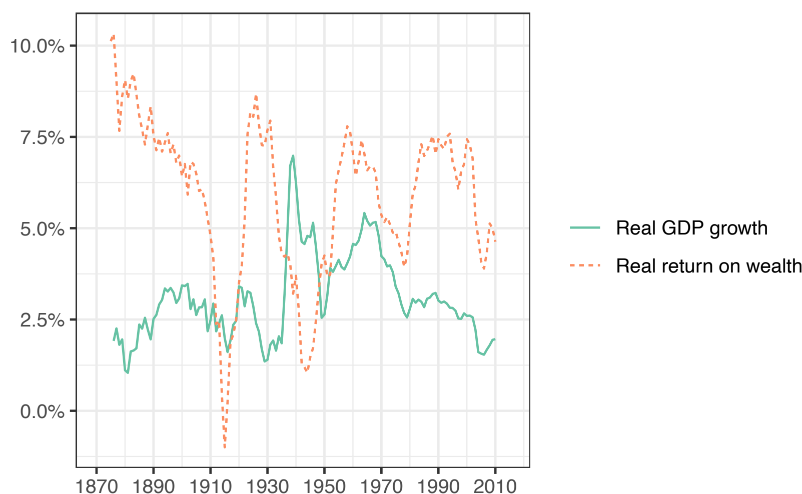
3. Capital abundance and the structural power of finance

To summarize the argument so far, the political economy literature explains financialization in the United States as the result of policymakers – for reasons specific to the American political economy between the late 1960s and early 1980s – turning to financial markets to solve problems of governability and profitability. My argument, although compatible with this conjunctural explanation, instead emphasizes the macroeconomic – and historically recurring – process of wealth accumulation as an underlying, structural cause. This section turns to the puzzle that arises from this argument – the strange non-death of the rentier in an era of financial capital abundance.

Keynes predicted that once the resource the financial sector controls became abundant, the "cumulative oppressive power of the capitalist to exploit the scarcity-value of capital" would decline. Recent economic history has borne out the first part of Keynes' prediction, but not the second: Finance capital has become abundant, but the rentier has returned to "rude health" (Christophers, 2020, p. 64). As per Piketty, the best measure of this health is the gap between the rate of return on capital (r) and the rate of economic growth (g) (Piketty, 2014). Subsequent work has shown this gap to have proven remarkably resilient in recent decades (Jordà et al., 2019). Reproduced in Figure 5, the data collected by Jordà et al. on real returns on wealth indicate a larger r-g gap for the four decades since 1980 than during any comparable period since the late 19th century.

Why, during this period of growing capital abundance, has the r - g gap not declined? Why has the rentier not been euthanized?

Figure 5: Real return on wealth and real GDP growth rate



Data: Jordà et al. (2019), The Rate of Return on Everything.

Note: Data for 16 advanced economies (United States, Japan, and 14 European countries), weighted by real GDP. Decadal moving averages. Rates of return reflect relative portfolio weights of different asset classes (bonds, bills, equity, housing).

It is noteworthy that in the era of the Great Crash of 1929, the Great Depression, and the New Deal, Keynes was by no means the only observer of the emerging "mixed economy" to conclude that the reign of finance was over. Berle and Means (1932) famously argued that the dispersion of formerly concentrated shareholdings had separated ownership from control – the unity of which had been the core feature of finance capital. This separation transferred economic power from shareholders – that is, wealth owners and their intermediaries – to corporate managers. Burnham went further still by arguing that the idea of a separation of ownership and control was without meaning because "[o]wnership means control; if there is no control, then there is no ownership" (Burnham, 1941, p. 87). For Burnham, shareholders had already become superfluous – "functionless investors", in Keynes' term.

The early 20th-century prophets of the end of financial-sector power failed to anticipate the power of (the threat of) exit and – when that power eventually declined due to the capital abundance predicted by Keynes – the return of ownership and control. The power of exit is well understood by political scientists today. The broader literature on the

structural power of business has generally focused on the ability of capital to threaten exit, that is, to hold back investment or to permanently move capital elsewhere (Block, 1977; Culpepper, 2015; Fairfield, 2015; Lindblom, 1977). The literature on the structural power of finance also emphasizes financiers' ability to (threaten to) withdraw credit or portfolio investment from firms, sectors, or entire countries (Strange, 1988), both in the Global South (Dafe, 2019; Naqvi, 2018; Roos, 2019; Winters, 1994) and in the Global North (Bell & Hindmoor, 2015; Culpepper & Reinke, 2014; Kalaitzake, 2020; Woll, 2014). Subject to certain scope conditions – such as issue salience, regulatory capacity, and intra-finance disunity (James & Quaglia, 2019; Massoc, 2019, 2021) – exit-based structural power is said to allow wealth owners and their intermediaries to "influence the policy choices of corporate and sovereign borrowers" (Harmes, 1998, p. 99).

My central proposition is that whereas capital scarcity increases the exit-based structural power of finance, capital abundance strengthens the ownership- and control-based structural power of finance. Hilferding saw in finance capital not just a source of financing but also a means of (re-)organizing industry. Hilferding clearly saw that the increased demand for bank liabilities – from capitalists whose profits exceeded what they could, or wished to, re-invest – forced banks to lend ever larger sums, be it via loans or the purchase of debt or equity securities. As a result of acquiring "a permanent interest" in corporations, banks faced the problem of *control* – corporations now had to be "closely watched … and so far as possible controlled by the bank in order to make the latter's profitable financial transaction secure" (Hilferding, 1985, p. 120). Hilferding's point stands that both in the US and in Germany, banks' role in corporate governance was geared towards minimizing competition, maximizing profits, and thus the ability of corporations to service their debts and pay out dividends.

This control-based understanding of the power of finance capital was largely forgotten in the political economy literature. It lived on, however, in two separate subfields – the sociology of the corporate elite and the French regulation school. The former focused on the power of corporate managers and the network of interlocking directorates. While scholars debated the relative influence of the corporate versus the financial communities, a consensus emerged that an "inner circle" existed whose power was rooted *not primarily in ownership* but in a dense and stable interlock network (Herman, 1981; Mintz &

Schwartz, 1985; Useem, 1984; Zeitlin, 1974). As did Berle and Means, this literature viewed the interlock network's concentrated power and lack of accountability as a threat to democracy. At the same time, precisely because the inner circle did not have to fear pressure from shareholders, it wielded its power pragmatically, accommodating organized labor and government regulation in the mixed economy (Mizruchi, 2013).

Hilferding's control-based understanding of the power of finance capital also continued to inform Marxist political economy scholarship, especially in the French regulation school. Taking his cue from Baran and Sweezy, Michel Aglietta diagnosed a strong tendency towards "capital concentration" for US capitalism. Like Hilferding, he understood finance capital as "the ultimate mode of capital centralization" that took "concrete form in financial groups" whose economic importance consisted in their ability to foster "the cohesion of finance capital" – that is, to act as aggregators and coordinators of the interests of wealth owners (Aglietta, 1979, pp. 253, 266). Writing in 1979 – and citing data for 1968 – Aglietta, when looking for the concrete institutional form of financial capital, found that banks dominated the landscape of financial intermediaries.

Since then, these institutions of "deposit saving" have been joined, and then increasingly overshadowed, by what Aglietta called institutions of "contractual saving" and what this paper refers to as "institutional capital pools." This diverse group consists, first and foremost, of not-for-profit institutional investors, notably pension funds and endowments (Clark & Monk, 2017). Insurers, for whose business model investing is a necessary – but not the primary – component, are the most important type of for-profit institutional investor (Kohl & van der Heide, forthc.). The largest category of institutional capital pools, however, are for-profit asset management companies. Just like pension funds pool the savings of many households, asset managers pool the capital of many institutional investors (as well as households). The asset management sector comprises, first and foremost, mutual funds and exchange-traded funds, as well as the less regulated and more leveraged institutions, namely hedge funds, private equity funds, and venture capital funds.[8] Although the distinction tends to get blurry in practice, there is a fundamental difference between institutional investors that are asset *owners*, and asset

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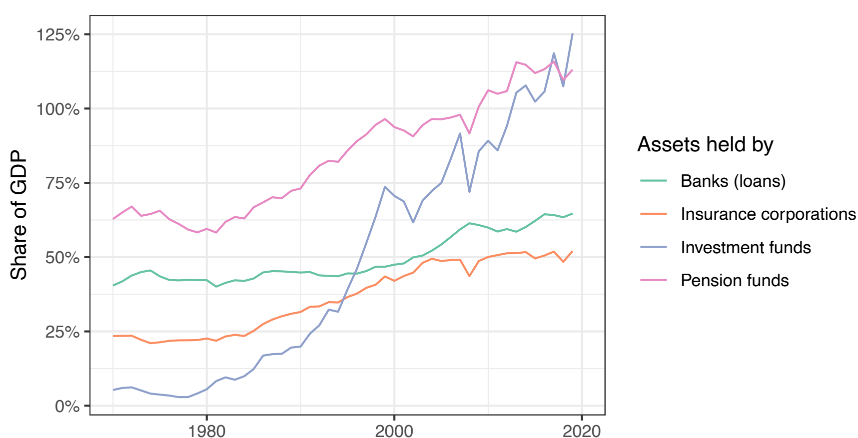
[8] To this list should be added the family offices of the super-rich (Glucksberg & Burrows, 2016).

managers that are pure intermediaries in the business of managing other people's money for a fee (Braun, 2016). As indicated by the eightfold increase of the securities segment in Figure 1 above, the asset management sector has seen exceptional growth over the past half century. What is more, since the global financial crisis of 2008 most global banks have greatly expanded their asset management arms, as have many insurers. On the list of the world's top-10 asset managers, the "Big-Three" asset managers (BlackRock, Vanguard, and State Street Global Advisors) are closely followed by the asset management arms of Goldman Sachs, Allianz, and the like.

Figure 6 charts the rise of institutional capital pools in the United States. It shows that the assets of investment funds started to rise steeply in the 1980s and especially the 1990s, and today stand at twice the level of bank assets loans. Figure 7 combines "investment funds" and "pension funds" into a category "institutional capital pools", and plots the available time series data for a selection of nine advanced economies. It shows that the rise of institutional capital pools is a global phenomenon. Bank lending has retained the top position only in Japan. The purpose of including Ireland and Luxembourg is to illustrate why national-level data understates the volume of assets controlled by investment funds, which – unlike bank loans, pension fund or insurance assets – are much more likely to be domiciled in offshore jurisdictions. For European mutual funds, the dominant asset management centers are Ireland and Luxembourg.

Figure 6: US bank assets vs. non-bank financial assets, share of GDP, 1970-2020

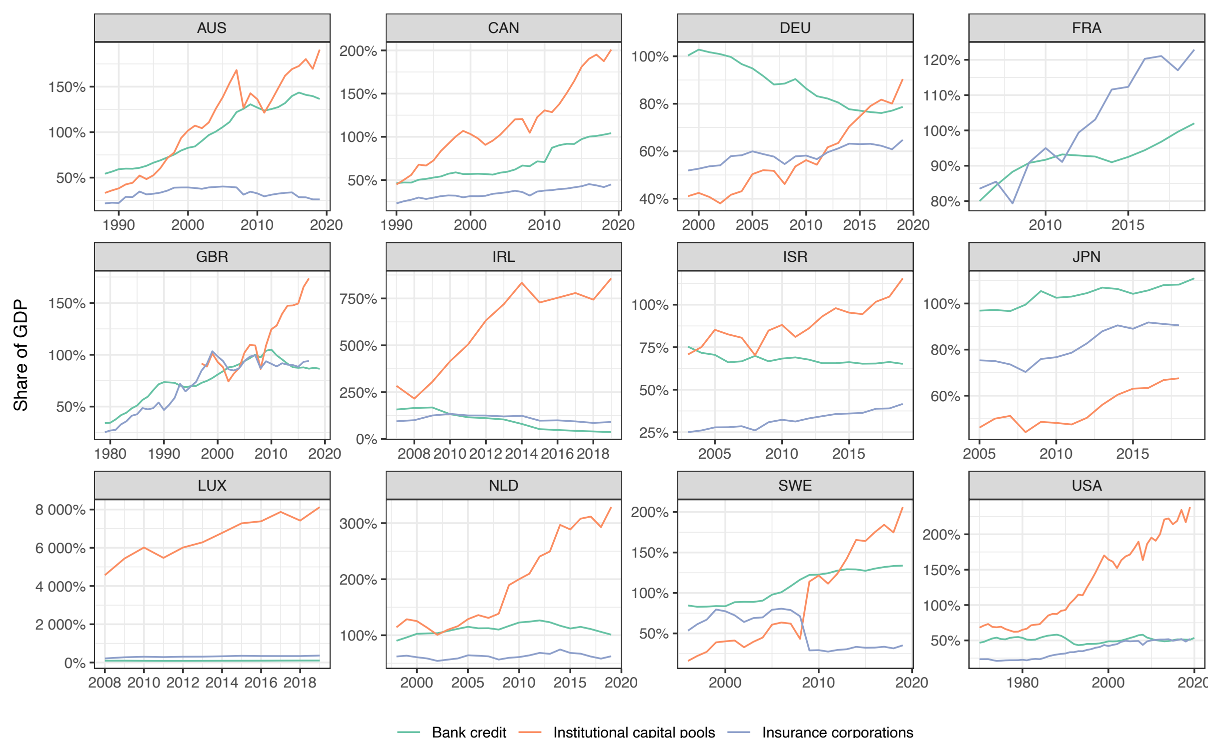


Data: Financial accounts of the United States.

Note: "Non-bank financial firms" includes both institutional investors (e.g., pension funds) and asset managers (e.g., mutual funds and ETF providers). Since the latter manage a large share of the assets of the former, the blue line reflects significant double counting.

The growth of institutional capital pools in general, and the concentration of the asset management sector in particular, have fundamentally reshaped financial markets and the structure of financial asset ownership. The consequences reverberate across various institutional spheres. One crucial sphere is the law, which wealth owners and their intermediaries have used to create ever new categories of financial assets, and to protect their owners against default or competing claims (Pistor, 2019, 2020). Another key institutional sphere is corporate governance. Here, share ownership concentration, believed to be an anachronism belonging to the finance capital era, made a comeback through the backdoor of the retirement-asset fueled lengthening of the investment chain (Braun, 2021; G. F. Davis, 2008; Fichtner et al., 2017; Gibadullina, 2021). As a result of this "Great Re-concentration", the United States is no longer the dispersed ownership society that scholars across disciplines and across generations – from Berle and Means, to Jensen and Meckling, to Hall and Soskice – took for granted.

Figure 7: Bank credit versus assets held by institutional capital pools and insurers, share of GDP, selected countries, various dates - 2020



Data: OECD (investment funds, pension funds, insurance corporations, GDP), Bank for International Settlements (bank credit to the private non-financial sector).

Note: "Institutional capital pools" is calculated as the sum of "investment funds and "pension funds."

4. Asset manager capitalism: Control *and* diversification

A comprehensive discussion of the control- and diversification-based theory of structural financial-sector power would need to consider all major asset classes, including listed and unlisted corporate equity, corporate, household, and government debt, as well as real estate. Due to space constraints, this section will focus on listed equity only.

Table 1 presents a stylized overview of the evolution of U.S. corporate equity ownership and corporate governance since 1900. Each of the four columns represents a distinct corporate governance regime, classified according to four criteria. The hallmarks of finance capitalism were a high concentration of share ownership, substantial control exercised by shareholders, poorly diversified portfolios, and therefore a strong shareholder interest in the performance of individual firms. This regime gave way under the early-20th-century diffusion of share ownership, which brought about the separation of ownership and control and ushered in the corporate governance regime of managerialism. Driven by the growth of institutional capital pools, the post-World War II decades then brought a "great re-concentration" of shareholdings. By weakening shareholders' exit options while strengthening their control, this re-concentration has fundamentally reshaped shareholder power. This section traces the return of ownership and control, and the perfection of diversification, by focusing on the two most recent corporate governance regime shifts in the United States – from managerialism to shareholder primacy, and from shareholder primacy to asset manager capitalism.

Table 1: Hallmarks of shareholder power under four corporate governance regimes

Main shareholders	**Robber barons**	**Households**	**Pension funds**	**Asset managers**
Concentration of ownership	High	Low	Medium	High
Control of shareholders	Strong	Weak: exit	Medium: exit or voice	Potentially strong: voice, no exit
Portfolio **diversification**	Low	Low	Medium	High (indexed)
Interest in firms	High	High	Medium	Low
Corp gov regime	**Finance capitalism**	**Managerialism**	**Shareholder primacy**	**Asset manager capitalism**

Source: B. Braun, 'Asset manager capitalism as a corporate governance regime.'

Key to the following is the "Berle-Means-Jensen-Meckling (BM-JM) ontology" (Braun, 2021, p. 2). Until recently, the corporate governance literature assumed shareholdings in the United States to be highly dispersed among atomistic, weak shareholders (the Berle-Means component) who are, nevertheless, the only stakeholders with a long-term interest in the economic performance of the corporation, whose governance they should, therefore, dominate (the Jensen-Meckling component). The main power resource of these individually weak shareholders is their ability to exit by selling their shares, thereby pushing down the share price and exposing corporate managers to the dangers of the market for corporate control (Callaghan, 2018). This ontology was central to the work of comparative political economists, who equated institutional investors in liberal market economies with "impatient" capital, in contrast to the "patient" capital provided by banks and other strategic blockholders in coordinated market economies (Culpepper, 2005; Goyer, 2011; Hall & Soskice, 2001; Höpner, 2003). However, the Berle-Means-Jensen-Meckling ontology does not map onto the new landscape of asset manager capitalism. The latter differs both from the bank-dominated, German und US finance capitalism of the early 20th century, and from the institutional investor-dominated, US and UK shareholder capitalism of the late 20th century, from which it evolved.

Shareholder primacy: Control through exit and voice

The literature on the decline of the managerial corporate governance regime points to two interrelated causal forces – the fracturing of the corporate elite and the rise of institutional investors, armed with new ideas about the economic function of capital markets. The former was, to a large extent, a collateral consequence of the dismantling, in the 1970s and 1980s, of the institutional counterparts of the corporate elite, namely organized labor and the Keynesian state. The corporate elite fractured because "[h]aving won the war, there was nothing left over which to fight" (Mizruchi, 2013, p. 199). The second causal factor is more relevant in the present context, namely the rise of new types of institutional capital pools, in close alliance with the highly influential law and economics movement. The latter took the corporate governance field by storm via the idea of a "market for corporate control" (Manne, 1965). This idea provided a stepping stone to Jensen and Meckling's agency theory of the corporation, which built three

axioms into the ideological infrastructure of corporate governance: a conflict of interest between weak outsiders (shareholders) and strong insiders (managers); the need, justified on efficiency grounds, to strengthen the rights of shareholders (as principals) vis-à-vis managers (as agents); and the elimination of workers from the analytical map. By the end of the 1970s, law and economics had reduced the complex political question of how to organize the corporate system to protecting outside investors against "expropriation" by insiders (La Porta et al., 2000, p. 4).

Law and economics scholars rationalized both the takeover wave and the subsequent, pension fund-driven corporate governance as part of the same movement towards greater economic efficiency (Jung & Dobbin, 2015; Zorn et al., 2005). In the 1980s, buyout firms ("corporate raiders") systematically dismantled the conglomerates managerialism had built (Fligstein, 1990; Useem, 1993). According to the efficiency view, this "downsize and distribute" model created smaller, more focused corporate units that could be more easily monitored by, and whose value was therefore more transparent to, outside investors (Lazonick & O'Sullivan, 2000; Zuckerman, 1999). The market for corporate control had become a reality, increasing both exit-based and control-based structural power.

The rise of buyout firms coincided with the growth of public pension funds, whose share of listed corporate equity increased from one per cent of the total in 1970 to eight per cent in 1990. Their equity stakes in individual corporations often approached but rarely exceeded one per cent – small enough to make exit a credible threat, but large enough for considerable voice in corporate governance (G. F. Davis, 2008). Crucially, while following the diversification imperative of modern portfolio theory, these pension funds were nevertheless active, stock-picking investors who took an active interest in the performance of their portfolio companies. This interest manifested itself in aggressive, pension fund-led campaigns for corporate governance reforms – against poison pills, and for independent directors, destaggered boards, and proxy voting (Webber, 2018, pp. 45–78). These reforms significantly strengthened the voice dimension of the structural power of shareholders, while helping to destroy the inner circle (Chu & Davis, 2016, p. 750).[9]

[9] Students of interlock networks have since shifted their attention to the global level (Heemskerk & Takes, 2015; Murray, 2017; Vitali et al., 2011).

By the mid-2000s, the "revolt of the owners", which had begun in the 1980s, was declared over (Useem, 1993). So resounding was the victory of these newly dominant shareholders that two legal scholars declared that "[t]he triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured" (Hansmann & Kraakman, 2001, p. 468). Their declaration of the "end of history for corporate law", however, could hardly have been time more poorly.

Asset manager capitalism: Control plus diversification

The re-concentration of shareholdings entered a new phase when, starting in the 1980s, institutional investors increasingly delegated investment to outside asset managers, who provided mutual, exchange-traded, hedge, private equity, and venture capital funds. Since the early 2000s, the explosive growth of a few asset managers has shifted U.S. stock ownership from dispersed to concentrated, with BlackRock and Vanguard being among most listed corporations' largest minority shareholders. This scenario was not anticipated. In a 2008 article on the "new finance capitalism", Gerald Davis, analyzing data up to 2005, identified a "surprising combination of concentration and liquidity" and noted that index funds "typically end up with smaller ownership positions in a larger number of companies" (G. F. Davis, 2008, pp. 20, 15). Although institutional capital pools had been growing in size, they had prioritized diversification over building up controlling stakes in fewer corporations. By 2008, however, BlackRock's average S&P 500 shareholding surpassed 5 per cent. Today, the public equity holdings of the largest asset managers combine full diversification with ownership stakes approaching 10 percent (Backus et al., 2020, p. 19). The joint holdings of the "Big Two" are approaching the 20-percent threshold commonly used in the comparative corporate ownership literature to identify controlling shareholders (Aminadav & Papaioannou, 2020).

This was a watershed moment – large, voice-affording stakes and full diversification ceased to be mutually exclusive; while liquidity – and thus the exit option – had evaporated. This combination makes asset manager capitalism historically unique, and the implications for the structural power of wealth owners and their financial intermediaries are by no means straightforward. In their quest for scale, large asset managers have essentially relinquished the option to *exit* individual investments

(Fichtner & Heemskerk, 2020; Jahnke, 2019). This is a consequence, first, of the size of their stakes in individual companies – which even in a liquid market cannot be sold without causing a major drop in the share price. Second, the loss of exit is a feature of the index-tracking investment strategies pursued by the majority of funds offered by the Big-Three asset managers. The existing theoretical framework would predict the structural power of large asset managers to be weakened by this loss.

The loss of the exit option is compensated, however, by the increase in *voice*. One source of asset manager voice is the brute voting power that comes with large shareholdings. Their voting power makes the large index-tracking asset managers key allies for hedge funds, which routinely seek the support of the Big Three for their activist campaigns. The second source of asset manager voice is diversification. The Big Three have promoted the narrative that their fully diversified ("universal") shareholdings make them the quintessential long-term shareholders, whose interests are aligned with environmental, social, and governance (ESG) objectives. Although the evidence in support of the "forceful stewardship" hypothesis (Fichtner & Heemskerk, 2020) has so far been mixed, the large asset managers' prominent role in recent ESG-related proxy fights points to the voice- and thus control-enhancing potential of diversification (Condon, 2020).

Whether asset managers actually wield their structural power, and in whose interest, remains an open question (Baines & Hager, Forthc.). If the logic of universal ownership is compelling in theory, in practice it is counteracted by a host of "agency problems", ranging from the cost of exercising voice to the cost of alienating the corporate managers who control the allocation of retirement plan assets to competing asset managers (Bebchuk et al., 2017). On the other hand, and by definition, structural power can be wielded in a cost-effective manner. BlackRock CEO Larry Fink's annual letters to corporate CEOs are likely to influence corporate behavior without any firm-specific deployment of voice by BlackRock. At the same, asset managers' dominant role in capital markets affords them infrastructural power vis-a-vis fiscal and monetary authorities (Braun, 2020). Hiring BlackRock to support their market operations has become routine for central banks around the world.

Conclusion

This paper has argued that financial capital has become abundant in advanced economies.[10] From this perspective, the puzzle posed by financialization is not the growth of the value-added share of the financial sector relative to GPD, which is overdetermined by the accumulation of unequally distributed wealth. Instead, the puzzle lies in the persistence of the structural power of finance under conditions of financial capital abundance, which diminishes the ability of wealth owners and their financial intermediaries to threaten to withhold financing or exit investments. Corporations' net demand for external financing has been declining for decades, and the stock market serves to move capital out of the non-financial sector. In the absence of exit, what institutions and mechanisms sustain the accumulation of financial wealth without driving r down into euthanasia-of-the-rentier territory?

Asset manager capitalism denotes an institutional configuration under which the structural power of wealth owners and their financial intermediaries is based on their ability to combine control and diversification. Whereas finance capital had achieved control over non-financial capital during previous periods of financialization, asset managers have only recently reached the scale needed to insulate investors from the success or failure of any individual components of their portfolios. Whether through holdings of the debt and equity of listed and, increasingly, unlisted corporations, or through their holdings of real estate and infrastructure assets, asset managers exercise unprecedented control over individual non-financial actors and sectors, while compensating for the loss of the exit option through diversification.

Like the smile of the Cheshire cat, the Berle-Means-Jensen-Meckling ontology continues to loom over corporate governance, but the rise of asset manager capitalism has pulled the empirical rug from underneath it. Whereas Burnham (1941, p. 87) argued that there could be no ownership where there was no control, asset managers exercise considerable control, yet ownership is fragmented and dispersed along the investment chain. In this topsy-turvy corporate governance world, old but long-dormant debates – about the

[10] Emerging market economies experience bouts of capital abundance but often at the whim of the global financial cycle (Bauerle Danzman et al., 2017; Naqvi, 2018; Rey, 2015).

legitimacy of control rights associated with stock holdings or about the costs and benefits public asset management and ownership – are being re-opened (Block, 2014; Buller & Lawrence, forthc.; McCarthy, 2019; Palladino, 2019).

Although this paper emphasizes the role of finance in determining the rate of return on capital, its claim is not that r is entirely a function of the structural power of finance. Politically, r is determined by government policies in areas such as labor markets, taxation and financial regulation. Whereas in the past the distribution of power between capital and labor may have sufficed to explain policy outcomes in those areas, the growth and financialization of household wealth have complicated the picture (Adkins et al., 2020; Pagliari et al., 2020; Pfeffer & Waitkus, 2021). Today, even middle-class households have a stake in the rate of return on capital, and thus "great expectations" of governments to protect their wealth (Chwieroth & Walter, 2019). The extent to, and the mechanisms, through which the structural power of financial intermediaries enhances the fortunes of wealth owners offers a promising avenue for future research.

Given their structural power, what do asset managers want? Whereas the literature on the financial sector's policy preferences has focused on financial regulation (Pagliari & Young, 2016), the rise of asset manager capitalism brings to the fore a potential shift in *macroeconomic* policy preferences. Simply put, banks – the core of the late-20th century "deflationary bloc" (Feygin, 2021) – benefits from stable growth rates and positive real interest rates, regardless of whether interest income derives mainly from business lending or from mortgage and consumer lending (Posen, 1995). By contrast, asset managers' overriding preference is for welfare state policies that increase private household savings and, crucially, for macroeconomic policies that sustain high asset prices. Whereas banks were the core constituency for restrictive monetary policies delivered by independent central banks, BlackRock has hired from the highest echelons of central banking in order to push for monetary easing and monetary-fiscal coordination (Braun, 2021, p. 24). This shift in financial-sector preferences has far-reaching implications for the political economy of macroeconomic policy, while raising new questions about the relationship between the financial sector's structural, infrastructural, and instrumental power.

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