ENDOGENOUS MONEY, CORPORATE LIQUIDITY PREFERENCES AND THE TRANSFORMATION OF THE U.S. FINANCIAL SYSTEM.

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Abstract

My dissertation examines the dramatic changes over the period 1951 to 2018 in the liquid asset ratio of U.S. non-financial corporations—i.e. the corporations liquid financial asset holdings as a share of their total asset portfolio. The aggregate corporate liquid asset ratio fell from 7.1 to 4.5 percent between 1951 and 1982, but then rose dramatically to 12.5 percent as of 2000, and has subsequently remained roughly stable at that peak level. These changes in the corporate liquid asset ratio are reflective of a broader transformation that has occurred in the U.S. financial system since the early 1980s. My approach in examining this transformation builds from the seminal 1957 paper by Hyman Minsky, "Central Banking and Money Market Changes." I argue that financial intermediaries—including the traditional banks, 'shadow banks' and other non-traditional institutions—affect nonfinancial corporations' liquid assets through two primary channels: 1) *The bank advance channel*, through which the intermediaries provide financing for the non-financial corporations' investment expenditures; and 2) *The liquidity preference channel*, through which the intermediaries substitute interest-bearing liabilities for traditional transaction deposits. Using the Minskian framework and working with both Johansen cointegration and Blundell-Bond Generalized Methods of Moments empirical techniques, I find that these two endogenous liquid asset creation channels have been important factors accounting for corporations' liquid asset holdings. I also find that the financial intermediaries' liquidity preference channel has gained in importance in recent decades in explaining the increased demand for liquid assets by nonfinancial corporations and the increased credits to finance trading in existing assets, such as mortgage loans, as opposed to creating new productive assets. My panel analysis further finds that financial asset holdings of large, high R&D spending, and high stock buyback firms are more sensitive to variation in financial intermediaries' liquidity preference. Overall, my results suggest that: 1) Financial innovations in the U.S. financial system over the past half century have contributed to an increase in credits to finance property transfers and a shift in nonfinancial corporations' asset portfolio composition towards liquid financial asset holdings rather than supporting the financing of productive asset creation; 2) Nonfinancial corporations in which finance departments are likely to actively manage the firms' asset portfolios, or where managers are likely to have relatively strong shareholder value orientations, tend to invest in liquid assets in an attempt to reach for yield; and 3) These and related patterns of financial innovation have become major factors driving the U.S. economy to the point at which, as Keynes would put it, enterprise has become increasingly a bubble on a whirlpool of finance.

Keywords: Endogenous money, Liquidity preference, U.S. financial system