How Quarterly Capitalism Stifles Investment And Wages

24/10/2013 BY GEORGE TYLER 2 COMMENTS

George Tyler

Weak American investment and weak wages are the consequence of weak corporate governance, with solutions to be found in Australia and northern Europe. Here are the facts:

First, real U.S. wages have gone flat since 1980 despite continued productivity gains, while in Australia and northern Europe they've mostly kept pace with productivity. Today, wages and comprehensive employer costs for labor are about $10/hour higher in Australia and northern Europe than in the United States. In manufacturing, German wages are $20/hour higher.

Second, investment by nonfinancial firms in Australia and northern Europe has outrun investment by American firms for decades, as documented by Eurostat economists Denis Leythienne and Tatjana Smokova in 2009.

Third, U.S. managers apply unreasonably high discount rates when evaluating future investments, truncating their investment time horizons compared to managers in these other rich democracies. James Poterba at MIT (and President of NBER) and Lawrence Summers, as early as 1995, documented that German managers devote a considerably higher share of R&D budgets to the long term than U.S. managers. Moreover, the Americans would forego "a very … ta, as reported … al.

Fourth, Australia and every nation in northern Europe now have more skilled labor forces than the United States. As recently as 1998, it wasn't that way, but skill levels in nations like Austria, Denmark and France have since leapfrogged the U.S. level, where firms eschew human capital investments. Employee loyalty now comes in two-week segments until the next paycheck, with longer term upskilling and the concept of employee commitment to the firm hollowed out. Firm management in these other rich democracies have done a superior job of investing anew, changing product mixes, upskilling workforces and offshoring few domestic jobs.

What are we to make of this? Globalization is fingered as the culprit by many who've written on U.S. wage stagnation, but it's a rather baffling explanation in light of the considerably greater integration of these higher wage nations like Austria, Denmark or Germany in cross-border trade. A few, including former labor secretary Robert Reich and James Galbraith are closer to the mark, pinpointing a variety of structural factors, like offshoring, Randian executive suites, weaker labor unions and deregulation.They and others such as Edmund Phelps, call this agency problem "short-termism." It's a focus by stock-optioned American management on near-term performance, being parsimonious with corporate outlays for R&D, wages, investment and the like in order to spike quarterly earnings.

Foolish mergers are another element of the syndrome as examined by Jeffrey Harrison of Richmond and Derek Olin of Texas Tech. This syndrome partly explains why net investment by U.S. firms is 4 percent of GDP now while profits account for 12 percent of GDP, when they both equaled about 9 percent in the late 1980s. That's also why John Asker and Alexander Ljungqvist of NYU and Joan Farre-Mensa of Harvard found that publicly held U.S. firms devote only 3.7 percent of assets to investment compared to 6.7 percent at privately owned firms. And it's why productivity per hour worked in northern Europe has grown one-third faster than in the United States since 1979 to the point that equivalence exists on the factory floor now in the United States, France and the Low Countries.

It's quarterly capitalism. What kind of managers would run U.S. companies like that, crimping longer term prospects? Well, managers like those expat East India Company officials lamented by Adam Smith. Then as now, changing their management incentive structure is the answer. And that means drawing on corporate governance techniques of firms in those rich democracies who figured out how to avoid short-termism. The architecture of American corporate governance should learn from the successful codetermination structure of northern Europe, which is, to a large extent, responsible for Germany being the world's highest performing economy. Shareholders will applaud codetermination because it means greater returns, as Larry Fauver at Tennessee and Michael Fuerst at Miami concluded in 2006. And a healthy byproduct of codetermination has been higher wages, with firms supporting the Australian wage determination structure linking wages with rising productivity.

There are several reasons to look askance at northern Europe, struggling to generate growth and reform the architecture of its monetary union. But those macro concerns should not deflect from the long-term success of their sturdy internal processes in broadcasting rising real incomes widely year after year. What a contrast to the grim outcomes and prognosis for U.S. family economics, featuring further income disparities, stagnant wages and weak productivity, GDP and job growth as far as the eye can see.

It is time for Americans to do what they do very well: draw on the best and brightest from across the globe for a solution to its poorly crafted corporate governance structure.

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About George Tyler

George Tyler began his career working in the United States Congress as an economic adviser to Senators Hubert H. Humphrey of Minnesota and Lloyd M. Bentsen of Texas and as Senior Economist on the Congressional Joint Economic Committee. Appointed by President Clinton as a Deputy Treasury Assistant Secretary in 1993, George worked closely with international financial institutions and in 1995 became a senior official at the World Bank. George is active in the Washington-based NGO Bikes for the World (BfW), serving as board Treasurer (bikesfortheworld.org). Partnering with a number of organizations abroad, BfW collects more than ten thousand used bicycles and parts each year for recycling to nations in the Caribbean, Central America, Asia, and Africa.

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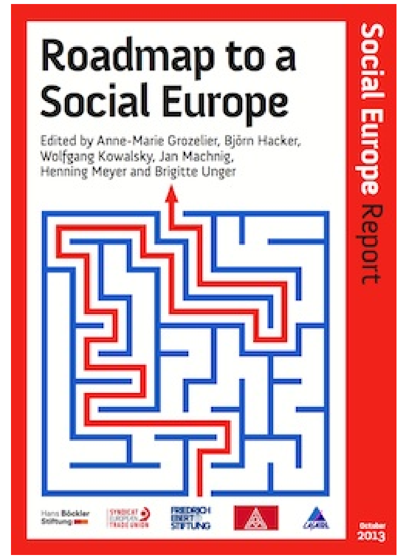

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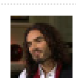
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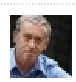
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