

Do Short-Term Incentives Affect Long-Term Productivity?

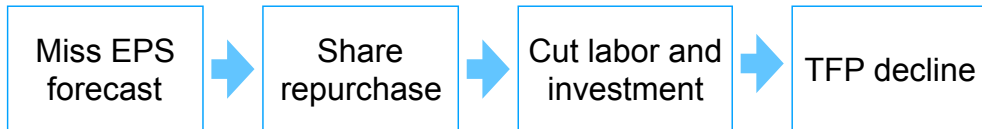
By Almeida, Ersahin, Fos, Irani and Kronlund

Discussion by Alex Xi He
University of Maryland

SFS Cavalcade

May 26, 2020

Overview



- ▶ Firms cut emp & investment in both productive and unproductive plants
- ▶ Downsizing of productive plants and TFP decline is concentrated in non-RTW (strong union) states
- ▶ Punch line: unions prevent firms from efficient downsizing and lead to long-term productivity losses

The New York Times

Opinion

Schumer and Sanders: Limit Corporate Stock Buybacks

Corporate self-indulgence has become an enormous problem for workers and for the long-term strength of the economy.

By Chuck Schumer and Bernie Sanders

Mr. Schumer and Mr. Sanders are U.S. senators.

Feb. 3, 2019



Comment #1: Why does TFP decline?

- ▶ Firm-level TFP decline could be due to two reasons: across-plant reallocation and within-plant productivity changes
- ▶ Reallocation effect is positive on average because more productive plants downsize less

Union power:

Dependent variable:

	RTW state		Non-RTW state	
	$\Delta Employment$	$\Delta Investment$	$\Delta Employment$	$\Delta Investment$
	[1]	[2]	[3]	[4]
<i>Negative Pre-Repurchase EPS Surprise</i> $\times$ <i>Productive</i> _{<i>t</i>-1}	-0.003 (0.006)	-0.002 (0.003)	-0.012** (0.005)	-0.007** (0.003)
<i>Negative Pre-Repurchase EPS Surprise</i> $\times$ <i>Unproductive</i> _{<i>t</i>-1}	-0.019*** (0.006)	-0.004 (0.003)	-0.024*** (0.007)	-0.008*** (0.002)
<i>Unproductive</i> _{<i>t</i>-1}	-0.008 (0.006)	-0.002 (0.003)	-0.019*** (0.005)	-0.004* (0.002)

Comment #1: Why does TFP decline?

- Is the TFP decline mostly a within-plant effect?

Dependent variable: Unit of observation:	ΔTFP	
	firm-year	plant-year
	[1]	[2]
<i>Negative Pre-Repurchase EPS Surprise</i>	-0.014** (0.007)	-0.012** (0.004)

- The paper shows firms with higher % plants in non-RTW states have larger TFP decline $\Rightarrow$ more direct test would be to include firm FE and compare plants in RTW and non-RTW states within firm

Why does TFP decline more after cuts when union is stronger?

- ▶ Non-RTW states cut more labor and have larger TFP declines:
 - ▶ If unions impede layoffs, they should cut less labor
 - ▶ If unions enjoy a surplus of labor, they should have higher TFPs after cutting labor

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 - ▶ If unions enjoy a surplus of labor, they should have higher TFPs after cutting labor
- ▶ Possible explanation: plants in non-RTW states fire “the wrong workers”
 - ▶ Caggese, Cuñat, and Metzger (2019): financially constrained firms fire short-tenured workers with high future expected productivity
 - ▶ Unions have “inverse seniority rules” in the US (Abraham and Medoff 1984)
 - ▶ Unionized labor prefer to restructure through layoffs rather than wage cuts (Brav, Jiang and Kim 2015)

Comment #2: How big is the effect?

- ▶ The RD design looks at pre-purchase EPS surprise in the $[-0.003, 0.003]$ range
- ▶ Using example in the paper, EPS forecast = \$3, # of shares = 1 billion, stock price = 60, to boost EPS surprise from -0.003 to 0 need to spend \$3.6 billion cash, or 6% of market cap

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- ▶ Wage bill is cut by 6.6% of assets after 3 years (12% decline from base level)
- ▶ Investment is cut by 0.9% of assets after 3 years
 - ▶ Small effect compared to other exogenous cash flow shocks: for example, in Rauh (2006), a CF shock of 1% of assets reduces CapEx by 0.6-0.7% of assets
 - ▶ Firms with maturing long-term debt cut investment by 2.5% of assets (Almeida et al. 2011) and cut employment by 1-2% (Benmelech, Bergman and Seru 2015)

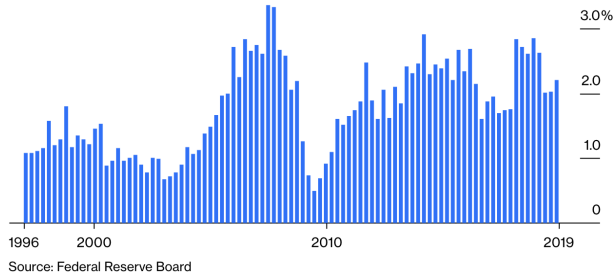
Why is labor absorbing most of the negative cash flow shock from stock repurchase?

- ▶ Sample selection: labor intensive industries? Firms with surplus of labor?
- ▶ Time period is more recent?
- ▶ Shock is too big to be absorbed by investment cut alone?
- ▶ Measurement of investment in Census (machinery investment > total investment in Table 1?)
- ▶ Reluctance to cut investment to boost earnings?

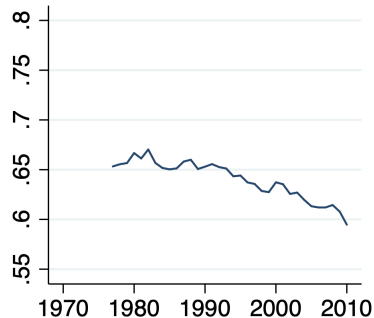
Comment #3: Policy implications

- ▶ Sanders and Schumer's proposal: firms are prohibited from buying back stock unless it invests in workers and communities first, including things like paying all workers at least \$15 an hour
- ▶ Interaction of stock repurchase and state minimum wage laws?

How much decline in labor share is from share buybacks?



(a) Buyback as % of GDP



(b) Labor Share

Conclusion

- ▶ Important and policy relevant question
- ▶ Provide first evidence that share buybacks harm long-run productivity
- ▶ More work is needed to understand why productivity declines