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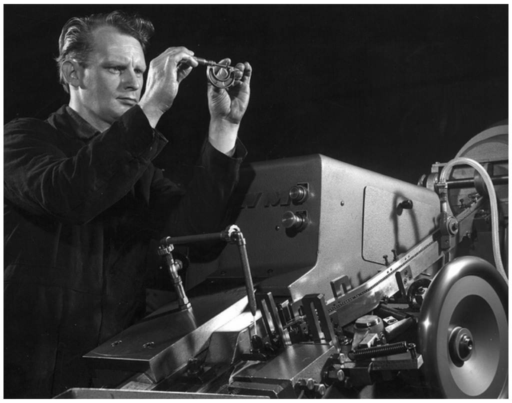

FAITH & BUSINESS

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The Wisdom of Shared Rewards — Part II

The prior column examined God's three foundational counsels to business people regarding compensation, focusing especially on Scripture's overarching principle of 'shared rewards' — the divine dictate that workers deserve not just wages, but a share in the wealth creation rewards of business success. Notably, this command comes to us initially through Moses, and then is interpreted and underlined by the Apostle Paul. Meaning God considers this command so important that he brings it to us through the principal authors of both the Old and New Testaments. And as Paul makes clear, articulating the shared-rewards command in terms of oxen was God's way of making emphatic its application to every worker, even down to the laboring oxen.

But while the prior column, hopefully, did a good job of explaining God's shared-rewards principle, it fell seriously short of spelling out the entirety of its wisdom. That's because the column narrowly focused on the benefits of shared rewards for business productivity — noting that profit-sharing and equity-sharing largely eliminate the 'us versus them' divisions that so sap efficiency, and enjoyment, from a great many businesses. Instead, such shared-rewards measures unleash entirely new levels of creativity and productivity … as evidenced by the extraordinary success of companies like Apple and Southwest Airlines.

But the wisdom of shared rewards extends far beyond its benefits for business. Its really big benefits are for society as a whole. Unfortunately, the reverse is also true. When business abandons shared rewards, society suffers. Striking new data makes clear just how damaging the downside effects can be.

But first, some background. During the middle decades of the 20th century, corporate America generally embraced a conception of business purpose which, later, came to be called 'stakeholder theory.' The essential idea was that corporations existed to serve the interests of several different sets of stakeholders — customers, employees, communities, shareholders, etc. But in the 1970s economists like Milton Friedman, and business academics like Michael Jensen and William Meckling, argued that the essential purpose of a corporation was simply to maximize the wealth of its shareholders.

This idea was immediately embraced by Wall Street, and then was adopted in a big way by business leaders in the 1980s. They were especially influenced by Jack Welch's 1981 speech "Growing Fast in a Slow Economy" in which he made clear that, henceforth, General Electric's primary objective would be to return maximum value to shareholders. This conception of corporate purpose has reigned supreme in America ever since. (It got considerable, but less, traction in other English-speaking countries, and very little traction in Europe.)

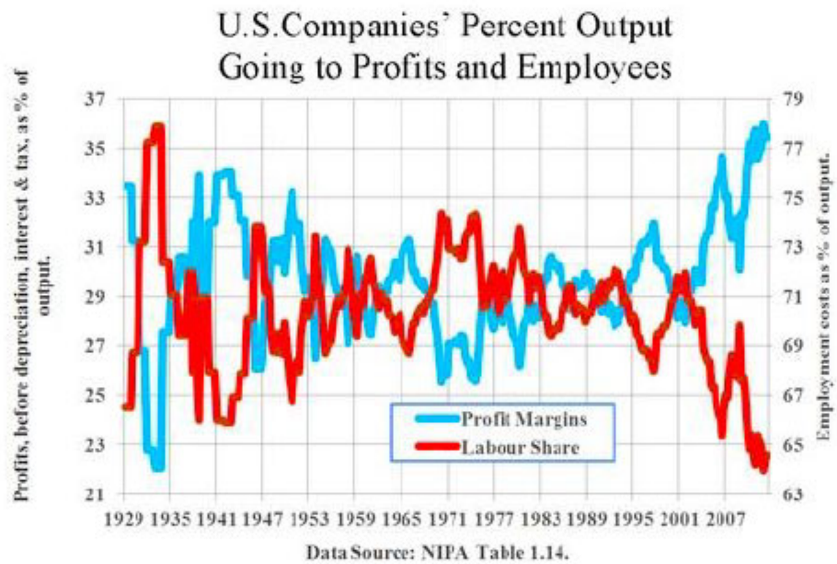
THE FALLOUT

As one would expect, this re-conception of corporate purpose has had dramatic consequences — the most immediate and direct being a substantial redirection of economic rewards from workers to shareholders (including, of course, senior

For quite some time now U.S. businesses have been directing more and more of their economic benefit to owners and less and less to workers. Today, the share of economic benefit that goes to workers has never been lower, and the share that goes to owners has never been higher.

management). We can see this especially clearly as a result of research by Andrew Smithers, a leading expert on financial economics and global asset allocation and regular contributor to *The Economist* and *The Financial Times*.

Smithers' rigorous analysis produced this highly instructive chart showing for the period 1929-2013 the proportion of economic output that U.S. companies directed to labor versus profits (to be distributed to shareholders).



As we can see, for quite some time now U.S. businesses have been directing more and more of their economic benefit to owners and less and less to workers. This change in favor of shareholders began in the 1980s but really picked up steam around 1995. Today, the share of economic benefit that goes to workers has never been lower, and the share that goes to owners has never been higher.

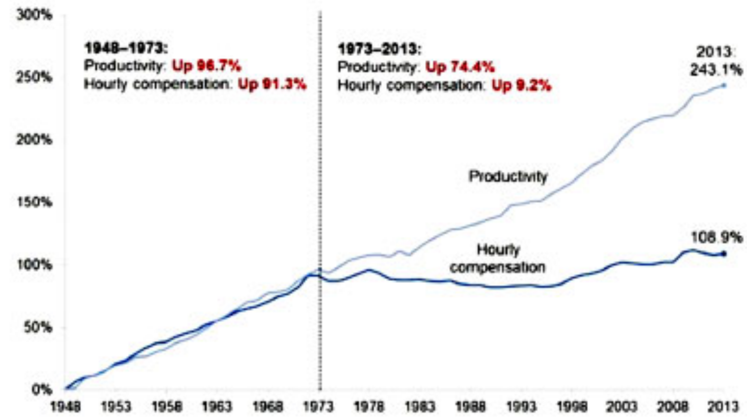
Smithers' data is hardly the only evidence that U.S. businesses are allocating rewards very differently today versus for much of the 20th century. Consider this chart from the Economic Policy Institute showing the relationship between U.S. worker productivity and compensation. Up until the mid-1970s, those numbers moved in virtual lockstep — from 1948-1973 worker productivity went up by 96.7% and hourly compensation went up by nearly as much, 91.3%. In other words, during that period the basic commitment from employers to workers was 'We will see that you get your fair share of the business rewards that flow from your growing productivity.' But over the last 40 years the story is entirely different — productivity went up 74.4% but compensation barely budged, up just 9.2% over four decades.

The rewards from growing worker productivity now go elsewhere.

Here's how Jan W. Rivkin, an economist and senior-associate dean for research at Harvard Business School, summarized the effect of the dramatic divergence between worker productivity and compensation: "The divergence indicates that companies and the people who own and run them are doing much better than the people who work at the companies." Rivkin then added these two trenchant observations:

In December the Pew Research Center reported that America's middle class is now a minority, having shrunk from 61% of the population in 1971 to 49.9% today.

Productivity vs. Compensation



Economic Policy Institute

> *The divergence that I described is not just a problem for the middle class, it's a problem for all of society. Without a strong middle class we see weak consumption. With unhappy workers we have a less productive set of people for business to hire. If we're only tapping the creativity and potential of a small fraction of our population that can't be good for society. If working, middle-class Americans are not thriving, eventually they become anti-business voters. So this should be a concern for the 1 percent not only ethically, but economically.*
>
> *Business leaders just need to recognize that companies can't thrive for long if their communities are struggling.*

THE SHRINKING MIDDLE CLASS

All of which provides a perfect segue. Two recent headline-garnering reports make clear just how grave the consequences are for society when business turns away from God's shared-rewards wisdom. In December the Pew Research Center reported that America's middle class is now a minority, having shrunk from 61% of the population in 1971 to 49.9% today. Their share of aggregate income has dropped even more — from 62% to 43%. By contrast, the share of income going to upper class households grew from 29% to 49% over that period. In fact, most of this gain has gone to the top 1% — their share of income grew from 8 percent in 1980 to 21 percent in 2008 to 37 percent in 2015.

And the situation for the middle class continues to worsen. As the Pew report notes:

> *Middle-income Americans have fallen further behind financially in the new century. In 2014, the median income of these households was 4% less than in 2000. Moreover, because of the housing market crisis and the Great Recession of 2007-09, their median wealth (assets minus debts) fell by 28% from 2001 to 2013.*

Not surprising, then, that upper income households now have seven times the wealth of those in the middle income bracket (up from three times as much in 1983).

All of which sounds simultaneously ominous … and way too abstract. A recent *MarketWatch* article headlined in rather more visceral terms the new reality for the American middle class (and working class): "Most Americans are one

"The world's quintessential middle-class society is on the way to becoming its first former middle-class society."
Joseph Stiglitz, Economics Nobel Laureate

paycheck away from the street." The story then notes that "62% of Americans have no emergency savings for things such as a $1,000 emergency room visit or a $500 car repair." In fact, that data may be overly optimistic. A U.S. Federal Reserve survey concluded that only 48% of Americans could cover a hypothetical emergency expense costing $400 without selling something or borrowing money. And only 39% had a 'rainy day' fund adequate to cover three months of expenses.

Why aren't people saving? The problem isn't just that the typical middle class family is making less today than 15 years ago. The aggravating factor is that costs for the biggest middle-class expenses have been soaring for decades. As a result, "a lot of people are in debt," says Andrew Meadows, a San Francisco- based producer of "Broken Eggs," a documentary about retirement. And it's no longer limited to the traditional burden of mortgage debt. According to Meadows, "Probably the most [onerous] types of debt are student loans and costs related to medical issues."

All of which means the basic perquisites of middle-class life are slipping beyond the reach of a growing share of Americans … as is any sense of economic security. Thomas Hirschl, a sociologist at Cornell and an author of *Chasing the American Dream*, conveys the psychological significance of this change when he observes, "If there's no security, there's no middle class." No surprise, then, that economist and former U.S. Secretary of Labor Robert Reich now calls the American middle class the "anxious class."

THE DYING WORKING CLASS

But even these observations understate the human toll that economic decline and insecurity are taking — especially for the middle-aged white working class. Angus Deaton, newly awarded the Nobel prize in economics, and Anne Case, both of them economists at Princeton, recently released a statistical study showing that the death rate for white Americans age 45-54, and with only a high school education or less, has risen dramatically over the last fifteen years. Among that group, death rates shot up by 22% — a rise caused entirely by drug and alcohol abuse, and suicide. This translates to nearly 500,000 premature deaths among the middle aged white working class.

Deaton and Case suggested a link between the spike in death rates and increasing financial distress, as have many subsequent commentators, noting that during the 1999-2014 period studied, the inflation- adjusted income for households headed by high school graduates fell by 19%. Nobel laureate economist Joseph Stiglitz draws a similar conclusion:

> *There was no way that this mounting financial pressure could not have placed middle- class Americans and their families under greater stress. And it is not surprising that this has been reflected in higher rates of drug abuse, alcoholism, and suicide.*

Many other esteemed academics sound similarly dire warnings. "It is difficult to find modern settings with survival losses of this magnitude," wrote two Dartmouth economists, Ellen Meara and Jonathan S. Skinner, in a commentary on the Deaton-Case analysis to be published in Proceedings of the National Academy of Sciences. "Wow," said Samuel Preston, a professor of sociology at the University of Pennsylvania and an expert on mortality trends and the health of populations, who was not involved in the research. "This is a vivid indication that something is awry in these American households."

Ronald D. Lee, professor of economics, professor of demography and director of the Center on Economics and Demography of Aging at the University of California, Berkeley, reacted especially personally and poignantly to the Deaton-Case study: "Seldom have I felt as affected by a paper," he said. "It seems so sad."

God's long-standing intent is for business, and business people, to be his partners in bringing widespread provision and prosperity. This is the explicit thrust of Deut. 8:17-18 where God links his gift of wealth creation — the unique capability of business — to the 'blessed to be a blessing' intention of his foundational covenant with humankind. In turn, shared rewards is God's first-priority dictate to help business people fulfill their provider calling. When business people do this well — i.e., when workers share appropriately in the wealth-creation rewards of business success — it accomplishes God's larger intent for a broadly prosperous society … a middle class society in which the vast portion of people live comfortably and poverty has all but disappeared (Deut. 15:4).

To the envy and admiration of the rest of the world, America's experience for much of the 20th century was an increasing, and increasingly prosperous, middle class. But then with 'shareholder value maximization,' American business pointedly veered from shared rewards into selfishness — and toward fortunes for a few rather than provision and prosperity for many. As a direct result, the economic condition of (much of) American society has become increasingly precarious. In turn, as Joseph Stiglitz observes, and the empirical data from Pew and Deaton-Case attest, "The world's quintessential middle- class society is on the way to becoming its first former middle-class society." Unfortunately, we are learning yet again that rejecting divine wisdom proves far more costly than we imagine. And, yes, it does seem so very sad.

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