What Hillary Clinton gets wrong about 'quarterly capitalism': Businesses are actually investing more than ever in R&D

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Conventional wisdom says American businesses are myopic, focused only on making their companies look good next quarter in order to temporarily get their stock prices up. The thinking is that this is endemic in corporate culture and is at the root of the sluggish economic recovery and the wide gap between the haves and have nots.

In a speech today, Democratic presidential hopeful Hillary Clinton dubbed this “quarterly capitalism.” Clinton proposed a few policy changes aimed at reforming this dysfunctional culture. Most notable was to change the way capital gains are taxed — the taxes paid on the gains enjoyed by investors in stocks and other assets.

The premise for her proposals is off-base: America’s businesses aren’t short-term focused, at least not to the degree that it impedes long-term economic growth.

If they were, then what explains the fact that businesses are investing so much in research and development? According to the Bureau of Economic Analysis, R&D investment is expanding at a robust double-digit pace — and has never been greater relative to the size of the economy. These investments are as risky as they get, and if they payoff it is generally long into the future.

Some argue that short-termism is evident in businesses’ big dividend payouts and stock repurchases. Getting this cash makes investors happy, but at the cost of limiting business expansion and job creation, they claim.

Not so. Businesses are making so much money they have plenty to do all of the above. Indeed, companies are devoting about the same share of their profits to dividends and repurchases as they always have. And job growth is about as strong as it ever gets, with jobs being created across all pay scales.

Wage gains have been tepid, but this still reflects the fallout from the Great Recession, when unemployment topped out in the double-digits. Unemployment and underemployment will be back to normal by this time next year if the current pace of job growth is sustained. Wage growth will accelerate.

Even if you don't buy into the view that our economy is plagued by quarterly capitalism, it is still good policy to incent businesses to invest more in their people and their own long-term growth. However, tinkering with tax rates on capital gains won't go far toward achieving that goal.

The shares of most American companies are held by large institutional investors, such as mutual funds, ETFs, pension and hedge funds. These investors are motivated by many things when buying and selling stocks. Whether the cap gains rate is a bit lower if they hold onto their stocks longer isn't one of them.

Moreover, activist investors who are interested in making a quick buck when they purchase a company's stock aren't likely to be dissuaded by such a tax change. Companies that are the targets of activists often do temporarily pull back on expansion plans in an effort to get their stock price up and ward off the activists. Yet this may ultimately force target companies to take the difficult steps needed to be more competitive, and to also create opportunities for competing companies that then enjoy even stronger growth.

Setting aside schemes to incentivize holding stock for a long period of time, broadly increasing capital gains taxes would help ameliorate the skewed wealth distribution. Most capital gains go to the very rich.

Taxing carried interest as normal income and not as a capital gain, also supported by Clinton, is a good idea. Private equity firms and hedge funds that earn carried interest when making investment decisions on behalf of their generally wealthy investors have abused this tax loophole.

But this should be done in the context of broader reforms to our corporate tax code. There is general agreement that our corporations pay too high a tax rate to be globally competitive. President Obama and Congressional Republicans have both put forward plans to reduce corporate tax rates and scale back loopholes.

Hillary Clinton has misdiagnosed what ails the U.S. economy. It isn't short-sighted American companies. It is a broken tax code.

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