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THE EFFICIENCY WAGE HYPOTHESIS AND THE ROLE OF CORPORATE GOVERNANCE IN FIRM PERFORMANCE[1]

Introduction

Implications of the digital economy and its impact on the Economics of Employment in the 21st Century are reflected through lower wages which have been fueled through the rise of Information Technology, with the consequential advents of phenomena such as the Fourth Industrial Revolution and the rise of emerging technologies such as Artificial Intelligence, block chain systems, Vertical Integration, Hyper-focused specialty lending, Lender-fintech partnerships, New engagement models, Product Innovation, to name but a few.

As well as a consideration of the two-fold contribution to the literature[2], as highlighted in their paper, "Financial Disruptions and the Cyclical Upgrading of Labor" (2017:6), and elaborated on by Epstein et al (2017:6-8), the reconciliation of two quantitative limitations[3] of current general equilibrium theories constituting part of such contribution, is also re iterated.

Against the backdrop of the two quantitative limitations presented by the canonical models, this paper highlights the need to incorporate other theories such as those relating to the economics of the firm – in explaining firm performance – given the previously highlighted limitations of "canonical models".

The inability to account for variables which are independent of exogenously or endogenously determined factors and which are outside their model, also necessitates the incorporation of other theories and factors to be taken into account in arriving at more accurate conclusions which determine firm performance.

Key words; efficiency wage hypothesis, pro cyclicality, financial cycles, firm performance, corporate governance

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[1] Jim DiGabriele and Marianne Ojo

[2] "In terms of their relevance for the labor search literature and also for the literature of financial imperfections."

[3] The two quantitative limitations of "the current general equilibrium theories of the labor market which emerge under standard calibrations" being:

- i) the canonical search model's inability to generate sufficiently high unemployment volatility (while generating plausibly high labor income and consumption volatility);
- ii) The OTJ search extended model's inability to generate sufficiently high labor income and consumption volatility (whilst nevertheless generating high unemployment volatility)."

The main objectives of this paper include the following:

i) To highlight the implications of the digital economy and its impact on the Economics of Employment
ii) To provide a cost-benefit analysis and assessment of associated emerging technologies on employment – morals and attitudes to work, and particularly moral hazard attributed impacts.
iii) To facilitate the above (ii) reference will be made not just to the Efficiency Wage Hypothesis, but also other relevant and applicable theories as a means of **contributing to literature** on this important topic.
iv) To critically evaluate how and why "traditional inflation" has been impacted by the advent of the digital economy (virtual currencies), and consequentially, the effects on wage levels.

Background and Review of Literature

According to Yellen (1984: 200), The models surveyed (in her paper) are variants of the efficiency wage hypothesis, according to which, labor productivity depends on the real wage paid by the firm. If wage cuts harm productivity, then cutting wages may end up raising labor costs. Hence, she argues, rather decrease wages – in a bid to employ more workers – as well as raise firm's revenue, firms are rather reluctant to do this since it would, overall, result in lower productivity.[4] In applying this to the dual labor markets, she adds that the Efficiency Wage Hypothesis applies to the primary sector – whilst under the secondary sector where anyone can obtain a job at a lower pay, the market is addressed to an extent as a result of employees who are willing to accept lower wages – even though this does not fully address involuntary employment.

Epstein et al (2017) find that "the interaction with "On the Job" (OTJ) search with financial shocks is substantially different from its interaction with Total Factor Productivity (TFP) shocks, such that under standard calibrations, their model generates aggregate dynamics exceedingly in line with the behaviour of key U.S macro data across several decades and in the wake of the Financial Crisis as well."

In particular, they argue that whilst the implications of OTJ shocks during periods of productivity shocks are well understood, their aggregate impact during periods of financial shocks are not so clear. A key finding of their paper is namely, that (2017: 4) " accounting for financial shocks relaxes endogenous wage rigidities associated with the presence of OTJ search with offsetting the high volatility of unemployment inherent to the presence of OTJ search."

[4] "That any reduction in the wage paid would lower the productivity of **all** employees already on the job".

Further important points are also emphasized:

- In their aim to develop a better understanding of how Job to Job flows interacts with financial shocks, they find that such interaction is distinct from those interactions between Job to Job and total factor productivity (TFP) shocks and that aggregately accounting for On the Job searches, TFP and financial shocks can induce aggregate dynamics which accord with the behavior of key U.S macro economic variables across the decades as well as that which prevailed during the Financial Crisis.
- However, they conclude that neither total factor productivity nor financial shocks could provide adequate explanations for the slow recovery pace which occurred following the Financial Crisis – hence the incorporate of other factors such as uncertainty and balance sheet repair as being contributory factors to the slow pace of recovery.

Main Issues to Be Addressed

Hence the main issues to be addressed in this paper relate not only to accounting for adequate explanations for the slow recovery pace following the Financial Crisis;

But also to incorporate theories as a means of accounting for other gaps in the literature, as well as considering the impact of emerging technologies and the digital economy on labor markets.

Other Theories to Be Considered

Principal Agent Theory

Fama(1980). "Agency Problems and the Theory of the Firm" Journal of Political Economy, Vol 88, pages 288-307

Theory of the Firm
Jensen and Meckling (1976). "Theory of the Firm: Managerial Behaviour, Agency Costs, Ownership Structure." Journal of Financial Economics, Vol 3 305-360

Corporate Governance Theory
Corporate Governance and Firm Performance (Bhagat and Bolton)

Moral Hazard Considerations

How employers can effectively design contracts – particularly long term contracts – such that they:

1) Do not unduly encourage lax attitudes by employees:
Who regard themselves as being too important (to the company) to be fired – hence overly conveying the assurance of job security

2) Whilst also incorporating necessary incentives and considerations into such contracts.

Loyalty schemes, bonuses, perks have their place of importance – so also motivation and morale amongst employees. Justifications for rewarding and encouraging certain "prized" employees than others vital. Newly employed workers should also be appreciated where they have demonstrated or possess skills which are as important as those that have been acquired by longstanding firm employees.

Corporate Governance and Firm Performance

According to Bhagat and Bolton (2007:8), efforts to improve corporate governance should focus on stock ownership of board members - since in their opinion, it is positively related to both future operating performance – as well as the probability of disciplinary management turnover in poorly performing firms. Of further interest, are observations made in relation to the negative relationship which exists between board independence and future operating performance, which in their view, could place board independence in a position of merit – where such is targeted as a means of "disciplining management of poorly performing firms".

"Greater stock ownership by the board", they further add, "would help internalize costs (and benefits) associated with greater disclosure as highlighted by Hermalin and Weisbach (2007) (cited) at the decision making (board) level."

Related research questions and Recommendations to be included in the FINAL DRAFT of this paper are as follows:

What are the implications of the digital economy for the economics of employment?

To what extent are the dual mandates of price stability and maximum employment linked? Further, is one mandate accorded unduly greater attention than the other?

What other factors (asset bubbles inclusive) may have contributed to the puzzle generated within the field of economics in respect of the inability to adequately account for prevailing and recent wage levels?

Conclusion (Subject to further amendments to be incorporated in the FINAL DRAFT of this paper)

With an increasingly digitalized and intertwined global economy, fueled by increased and advanced information technologies, as well as impacting sectors of ecommerce on the financial – and indeed conglomeratized sectors, new and evolving forms of risks have necessitated the skills and expertise of specialists such as forensic accounting experts – as a means of addressing gaps resulting from inabilities of traditional audit techniques to effectively address and manage such risks – particularly in a timely manner. Further ,whether risks such as risks of corruption - as varies according to different cultures and environments can effectively be managed by auditors, also constitutes growing interest.

Herein lies a growing role and the forging of a more formidable identity by forensic accountants. See also (Huber and DiGabriele). Understanding different cultures – in efforts aimed at addressing fraud and corruption, is not only essential to current jurisdictional and collaborative efforts, but also vital to addressing and managing cross service sector risks – as well as newly evolved risks associated with globalization and conglomeration.

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