

The Profit-Investment Puzzle: Some Observations and Questions

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Historically there has been a high correlation between profits and investment for the US nonfinancial corporations. A whole series of heterodox macroeconomic models placed the link between profits and investment at the center. However, starting in the second half of 1980s and especially after 2000, the correlation between profits and investment has become weaker. Moreover, the correlation between debt and investment has also become weaker. This weakening of the profit-investment link is sometimes referred to as the profit-investment puzzle. There are potentially two sets of explanations for the weakening correlation: Explanations focusing on nonfinancial channels and explanations focusing on financial channels. The former includes increased industrial concentration, globalization of production and relative productivity/price movements in investment and consumption goods producing sectors. The later includes the rising shareholder value and increasing financialization of nonfinancial corporations. In this paper, we discuss to what extent these alternative channels help us understand the weakening of the profit-investment link and asses their explanatory power using macro, sectoral and firm-level data. We discuss the explanatory power of heterodox macroeconomic models in the light of the empirical findings.