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The Myth of Corporate Cash Hoarding

Companies hire more workers when there's income to pay them. They don't liquidate financial assets.

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American nonfinancial corporations were "sitting on" $1.93 trillion in liquid assets at the end of last year's third quarter, according to the Federal Reserve Board. This has become one of the most frequently echoed statistics, viewed as indisputable evidence that U.S. business leaders are unduly timid or evil.

Last September, Chris Matthews, the host of MSNBC's "Hardball," asked Politico's Charles Mahtesian, "You think business can sit on those billions and trillions of dollars for two more years after they screw Obama this time? Are they going to keep sitting on their money . . . to get Mr. Excitement Mitt Romney elected president? Will they do that to the country?" Mr. Mahtesian concurred.

More recently, Washington Post columnist Harold Meyerson opined that, "U.S. corporations can't sit on their nearly $2 trillion in cash reserves forever, but that doesn't mean they're going to invest their stash in job-creating enterprises within the United States." And the "nearly $2 trillion in cash" was included in this newspaper's four key numbers of the year—right up there with jobs, oil prices and world trade. "In an ideal world," that report suggested, "2011 would see cash-rich companies step up their hiring."

Like so many statistics used to score political points, this datum de jour has been totally misunderstood. The chorus of media outrage about supposedly excessive corporate cash reveals nothing about the financial health of any U.S. business. It simply reveals appalling ignorance of elementary accounting.

Consider four basic points:

1) There are two sides to a balance sheet: assets and liabilities.

2) Liquid assets serve as a vital safety cushion to minimize the impact (on workers and suppliers) of unanticipated business difficulties.

3) A corporate balance sheet is not an income statement.

4) Corporations commonly use both internal and external sources of funds to acquire both real and financial assets at the same time. Larger investments in money-market funds and bank CDs do not mean smaller investment in plant and equipment, as many seem to imagine.

Point No. 1, about two-sided balance sheets, reminds us that single-entry bookkeeping will not do. The financial health of corporations is not measured by the form in which assets are held (liquid or not), but by net worth.

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From 2007 to September 2010, the value of nonfinancial corporate real estate fell by more than 30%—a loss of more than $2.8 trillion. The ratio of cash to total assets rose largely because the value of total assets collapsed. Meanwhile, liabilities topped $13.6 trillion last fall, up from $12.9 trillion at the last cyclical peak. With real estate falling and debts rising, the net worth of nonfinancial corporations was only $12.6 trillion at last count—down from $15.9 trillion in 2007.

Point No. 2, about safety cushions, alerts us to the fact that $1.93 trillion of liquid assets would not begin to cover $3.67 trillion of short-term debts, let alone ongoing expenses such as payroll. To describe the liquid assets as "hoarding" (regardless of debts) is witless. The recession in 2008-09 would have been far less painful if nonfinancial corporations in 2007 had been "hoarding" more liquid assets (they had $1.53 trillion).

Point No. 3, about the difference between a balance sheet (what a company owns and owes) and an income statement (money received and spent) is basic accounting. Outraged proclamations about the $1.93 trillion figure show zero understanding of this difference.

Firms hire out of income, not by liquidating assets or adding to debt. No sensible employer plans on meeting routine payroll expenses by drawing down assets, liquid or not.

Decisions to increase or reduce hiring are unrelated to decisions to increase or reduce any assets on the balance sheet. Companies add workers if the expected addition to after-tax revenues is likely to exceed the addition to costs (including taxes and mandated benefits).

Point No. 4 is related to Point No. 3. Consider that in the balance-sheet section of the Federal Reserve flow-of-funds accounts, where the now-famous $1.93 trillion appears, investments in liquid assets are a use of funds, not a source of funds.

Sources of funds are both internal (profits) and external (debts). Uses of funds include adding to financial assets. The Smith family may invest part of its monthly paycheck in a bank CD or mutual fund and the Jones Corporation may likewise invest part of its monthly profits in the same way. Such liquid investments are viewed as something that could be tapped to meet unexpected expenses, or to make longer-term investments later—not as a substitute for regular monthly income.

Another use of funds is capital expenditures on tangible assets—plant, equipment and inventories. Such capital expenditures by nonfinancial corporations (at home, not abroad) were growing at an annual rate of nearly $1.1 trillion in the third quarter of 2010—a 42% increase from $752 billion in the second quarter of 2009. U.S. corporations obviously can and do increase their investments in plant and equipment at the same time they are increasing investments in so-called "liquid" assets (which include bonds, time deposits and mutual funds).

The widely repeated notion that prudent corporate investments in liquid assets have somehow reduced real investments or hiring is unqualified nonsense based on inexcusable ignorance of elementary economics and accounting.

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