# End Stock Buybacks, Save the Economy

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By William Lazonick and Ken Jacobson

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Opinion

Since the 1980s, corporate boards in the United States have embraced as dogma the position that companies should be run primarily for the benefit of their shareholders. The stranglehold of this doctrine of “shareholder-value maximization” over corporate decision making has been a leading cause of inequitable incomes, unstable employment, and sagging productivity.

The principal tool for extracting value from companies and handing it to shareholders is the stock buyback, which usually boosts a company’s stock price. Buybacks are favored by top executives, who are paid primarily in stock options and stock awards, and encouraged by ever-more-powerful hedge-fund activists. From 2008 to 2017, 466 S.&P. 500 companies distributed $4 trillion to shareholders as buybacks, equal to 53 percent of profits, along with $3.1 trillion as dividends.

The growing use of stock buybacks since the mid-1980s has warped the economy, worsening inequality, distorting corporate decision making and diverting resources from investment in employees and hard assets. Congress is taking notice: the Reward Work Act introduced by Senator Tammy Baldwin in March would ban stock buybacks done as open market repurchases. (It would still allow buybacks done through tender offers, which are used for different purposes.)

The Securities and Exchange Commission, whose mandate includes stock market regulation, opened the floodgates to stock buybacks in 1982, when it adopted Rule 10b-18. Promulgated without public comment, the rule gives a company a “safe harbor” in repurchasing its own stock on the open market if it meets certain conditions, among them, restricting its buybacks on any single trading day to no more than 25 percent of the stock’s average daily trading volume over the previous four weeks. If it stays within the safe harbor, a company can repurchase its stock in massive amounts without fear of being charged with manipulating the stock’s price.

Image

Stock buybacks are favored by top executives, who are paid primarily in stock options and stock awards.CreditBrendan Mcdermid/Reuters

Before the adoption of this rule, buybacks were not illegal, but companies refrained from doing them on a large scale because of the risk that the S.E.C. might bring manipulation charges. With this fear banished, buybacks began on a large scale in 1984.

Corporations already had a way to provide a yield to shareholders: dividends. But by 1997, stock buybacks had surpassed dividends as a mode of distribution to shareholders.

To understand the magnitude of this shift, we analyzed financial data from 232 companies in the S.&P. 500 Index that were publicly listed in 1981, before the rule, and were still public through 2016. We found that from 1981 to 1983, these companies spent 4.3 percent of profits on buybacks. In comparison, from 2014 to 2016, these same companies spent 59 percent of their profits buying back their own stock. Dividends absorbed just under half of profits in both periods.

The Rule 10b-18 daily limit on stock buybacks isn't much of a limit at all. Apple, for example, could buy back $1.4 billion worth of its stock in a single day without exceeding it. And as long as Apple's board adopts a buyback program to permit it, senior executives can keep buying back similar amounts of stock, trading day after trading day.

Defenders of buybacks contend that they do no harm because the funds are reallocated through financial markets and used elsewhere in the economy. A company's profits are, however, the financial foundation for investments in productive capabilities, first and foremost in employees. Investment in training and retaining employees is the key to productivity growth and innovation, for individual companies and for the economy. According to our research, when trillions of dollars of corporate cash are extracted from companies through buybacks, on top of dividends, the result is a dramatic concentration of income among the richest American households and the destruction of middle-class employment opportunities.

In 2003, the S.E.C. revealed that it was aware of the use of buybacks to manipulate the stock market. The agency acknowledged, in amending Rule 10b-18 to include block trades, that "during the late 1990s, it was reported that many companies were spending more than half their net income on massive buyback programs that were intended to boost share prices — often supporting their share price at levels far above where they would otherwise trade." But its 2003 amendment was hardly a solution.

From 2003 to 2007, the value of buybacks by companies in the S.&P. 500 Index quadrupled, reaching almost $600 billion in 2007. With their cash reserves depleted by this orgy of buyback activity, these companies were more vulnerable when the downturn came. Having wasted billions on buybacks, many of them incurred huge losses and required mass layoffs to avoid bankruptcy.

After plummeting in 2008 and 2009, buybacks have again soared: A record $800 billion in buybacks by S.&P. 500 companies is predicted for this year.

Democrats have argued that the Republican tax cuts have funded increased buybacks. While this is true, the damage done by corporate stock buybacks over the past decades has been systemic.

Short of a Congressional ban on buybacks, as Ms. Baldwin proposes, the S.E.C. should immediately rescind Rule 10b-18, and confront the reality of stock market manipulation that open market repurchases entail. If Congress and regulators do not take action to rein in buybacks, the rampant economic inequality that already afflicts the United States will only get worse.