The Daily Dish

Correcting the Record on Stock Buybacks

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Eakinomics: Correcting the Record on Stock Buybacks

Perhaps nothing has been more misunderstood, demagogued, or both, recently than share repurchases (also known as stock buybacks). The practice got attention as part of misplaced critiques of the Tax Cuts and Jobs Act, but is now front and center because Senate Minority Leader Chuck Schumer and Vermont Senator Bernie Sanders took dead aim at it in a recent *New York Times* op-ed: "Our bill will prohibit a corporation from buying back its own stock unless it invests in workers and communities first, including things like paying all workers at least $15 an hour, providing seven days of paid sick leave, and offering decent pensions and more reliable health benefits. In other words, our legislation would set minimum requirements for corporate investment in workers and the long-term strength of the company as a precondition for a corporation entering into a share buyback plan. The goal is to curtail the overreliance on buybacks while also incentivizing the productive investment of corporate capital."

Why? According to the senators, "When a company purchases its own stock back, it reduces the number of publicly traded shares, boosting the value of the stock to the benefit of shareholders and corporate leadership." As a result, according to the authors, stock buybacks benefit only the affluent and serve to constrain the capacity of firms to invest in new plants and equipment, undertake R&D, pay higher wages, or offer more benefits.

One can only conclude that this string of non sequiturs masquerading as an argument is politically appealing, because it is certainly dead wrong.

To begin, stock buybacks do not enrich shareholders. To see this, imagine that a firm has 1 million shares of stock and is worth $500 million. The value of each share of stock is $500. Suppose further that $25 million of that value is simply the cash holdings of the company. A

stock buyback is using that cash to repurchase shares; in this case the $25 million will permit repurchase of 50,000 shares, leaving the firm with 950,000 shares outstanding. But at the same time, the firm is $25 million less valuable, as the cash has left the company. The new value of $475 million translates into exactly $500 per share.

The stock buyback did not make any shareholder richer. A stock buyback is simply the exchange of valuable stock for the same value in cash. It has no impact per se on anyone's wealth.

The critique also goes awry because relatively few shareholders are rich people. According to authors from the left-of-center Tax Policy Center, less than one quarter of corporate stocks are held by taxable accounts (and people are not the only taxable accounts, so the number of individuals is even smaller). The largest share (37 percent) is held by retirement plans, insurance companies, and non-profits. Stock buybacks do not create riches and are not targeted at the affluent.

Finally, no firm would pass up the opportunity to trade its cash ($25 million in my example) for capital investment, research, wages, or benefits if doing so created more than $25 in value. In that way, the largest misconception is confusing buybacks as the disease; they are simply the symptom of the fact that the firm does not have enough opportunities to pursue ways to raise its value. If it is simply a single firm, then the buyback allows the shareholder who receives the cash to plow it back into the financial system in the form of another stock, bond, or the like. Those funds become available to entrepreneurs, small businesses, and companies to make investments.

But if there are no such opportunities for the business sector as a whole, that is a real problem likely created by misguided policies. The solution to unsustainable budget deficits, trade wars, uncontrolled health spending, and other drags on future growth is to fix those policy problems — not to exacerbate the problem with further regulation.