The Daily Dish

Just Say No to Stock Buyback Stories

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Eakinomics: Just Say No to Stock Buyback Stories

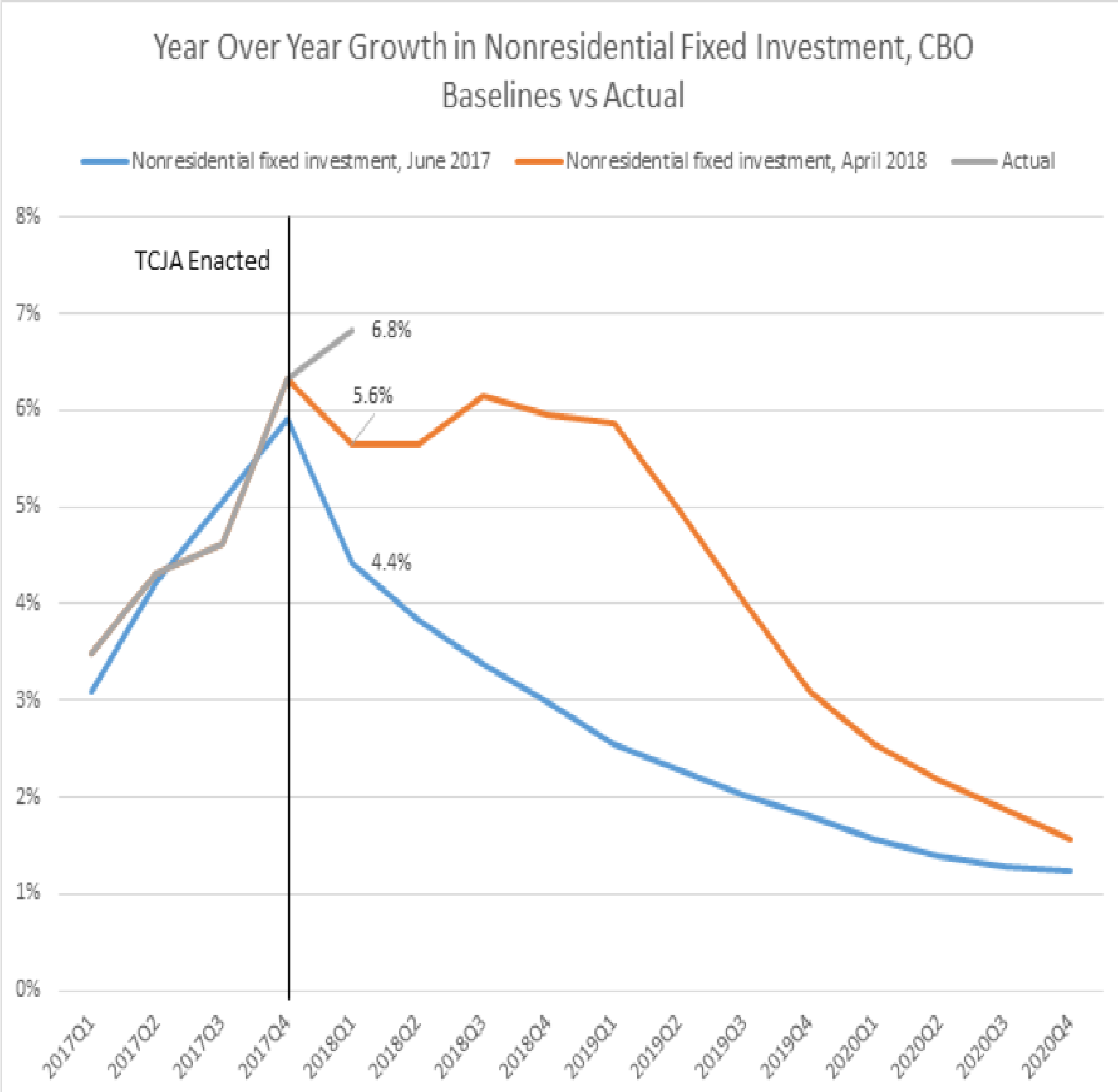
The point of this Eakinomics is that this recent CNN story — "Tax cut fuels record $200 billion stock buyback bonanza" — is wrong. And it is not alone.

There are lots of ways to collect preliminary evidence on the effectiveness of the Tax Cuts and Jobs Act (TCJA). One could check for increases in CEO and small business confidence. After all, sentiment can change quickly and is a good leading indicator of investment and growth. Sentiment is up sharply.

Or one could check whether the large amount of overseas corporate earnings is being repatriated for use in the United States — it would be a bad sign if, post-reform, these dollars were viewed as more profitable when used overseas. U.S. global firms have reported hundreds of billions of dollars in planned repatriations.

Alternatively, it is possible to track investment planning using the indexes of planned capital expenditures, whether from investment-bank research departments or organizations like the National Federation of Independent Business. These indices are at all-time highs.

Another possibility is simply to look directly at non-residential (i.e., business) fixed (i.e., not merely inventories) investment. For example, the chart below shows what path the Congressional Budget Office (CBO) projected these investments to take in its economic forecasts from last June and this April, versus the actual data reported through the first quarter of 2018. Investment performance thus far in 2018 is well above the pre-tax reform projection, and stronger than CBO estimated for the first part of this year. At 6.8 percent, it is at its highest rate since early 2014.



Finally, one might look just at growth. Year-over-year growth in gross domestic product (GDP) was 2.8 percent in the first quarter, the fastest since 2015. And the Atlanta Federal Reserve's "GDPNow" real-time tracker put growth in the 2nd quarter at 4.8 percent as of June 1.

But no. Instead I have to read and listen to report after report on stock buybacks. Let me repeat: *The economic impact depends on the final use of the money; the buyback is the first.* When the shareholder receives the cash, he or she can 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 — whether they are in worker training, quality and quantity of tangible and intangible capital, raises for workers, or new business models. Only then can CNN (or anyone else) find out if workers have benefited directly and/or indirectly from tax reform. Strike one.

Also: *stock buybacks do not raise stock prices*. To see this, imagine Eakinomics, Inc., a small firm worth $1,000 consisting of $500 in tangible and intangible capital and $500 in cash. If there are 1,000 shares outstanding, each share is worth $1. If Eakinomics, Inc., uses its cash ($500) to buy back shares, it will buy back 500 shares.

What happens to the stock price? Eakinomics, Inc., now has $500 in assets and 500 shares outstanding — still $1 per share. What happens to shareholders? They used to have $1,000 in shares. They now have $500 in shares and $500 in cash. Stock buybacks do not enrich shareholders or raise share prices. Strike two.

Finally: *whether the TCJA raises or lowers inequality cannot be known at this time.* Certainly you can't learn this from stock buybacks. According to authors from the liberal 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, as well as insurance companies and non-profits. Stock buybacks are not simply targeted at the affluent. Their ultimate impact on the distribution of income will depend on the core economics of investment, productivity, and real wage growth. It is simply too soon to tell. Strike three.

Evidently the media cannot stop writing and airing stories about TCJA and stock buybacks. But you don't have to waste your time reading and watching.