

The Academic-Industry Research Network

BUYBACKS: FROM BASICS TO POLITICS

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BUYBACK BASICS

What are stock buybacks?

It has become common for publicly listed business corporations to repurchase their own outstanding shares. In the United States, the vast majority (an estimated 90%) of stock repurchases, or stock buybacks, are done on the open market; the company instructs its broker to buy the shares from whoever wants to sell them. [A company can also repurchase shares through a private transaction or a publicly announced tender offer made to its existing shareholders. The term “buybacks” is used in this report to refer to open-market repurchases only.]

What is the difference between a buyback program and actual buybacks?

By adopting a **buyback program**, the company’s board *preauthorizes* the repurchase of a certain value of the company’s shares over a certain time frame: for example, a buyback program may consist of \$10 billion in repurchases over four years. In some cases, the expiration date of the program is left open. Simply adopting a program does not require a company to do any or all of the buybacks that have been authorized. The board can decide to modify the existing buyback program at any time.

A company does not disclose the particular days on which it is doing **actual open-market repurchases**. Even after the fact, daily buyback activity is not disclosed to either the public or the Securities and Exchange Commission (SEC). Under the SEC’s only disclosure rule, which dates to 2004, a company is required to report its monthly buyback totals on the 10-Q forms it files with the SEC after the end of each quarter.

How are buybacks regulated?

Since November 1982, SEC Rule 10b-18 has governed buybacks. This rule gives a company a “safe harbor” against charges of manipulating its stock price as long as *the volume of buybacks done on any single day does not exceed 25% of the average daily trading volume (ADTV) of the company’s stock over the previous four calendar weeks*. For many large companies, the 25% ADTV can equal \$200 million or more in buybacks per day. And, within the safe harbor, buybacks of these magnitudes can be done day after trading day. To be covered by the safe harbor, the company must in

addition: refrain from doing buybacks at the beginning or end of the trading day; do all its buybacks on any given day through a single broker; and do the buybacks at the prevailing market price.

Exceeding the 25% of ADTV daily purchase limit, or transgressing any of the other three safe-harbor criteria, is not in itself considered evidence that the company has manipulated the market. Since the SEC does not require disclosure of the amounts of stock repurchased on particular days, the regulatory agency would have to launch a special investigation even to determine whether the 25% ADTV limit had been breached. In the more than three decades that Rule 10b-18 has been in effect, it has been exceedingly rare for the SEC to conduct an investigation into the use of buybacks to manipulate the market.

BUYBACK BINGE

Over the past three decades, Corporate America has become addicted to stock buybacks. Until the mid-1980s buybacks were insignificant. But since then, buybacks have become [massive and pervasive](#). For the decade 2005-2014, US corporations' total net equity issues – new share issues less shares taken off the market through buybacks and merger-and-acquisition deals – averaged *minus \$399 billion per year*.

Over the past three decades, in aggregate, dividends have tended to increase as a proportion of corporate profits. Yet in 1997 buybacks surpassed dividends in the US corporate economy. While buybacks are more volatile from year to year than dividends, they have become more dominant as a mode of distribution of corporate cash to shareholders. Over the decade 2005-2014, 458 companies in the S&P 500 Index in February 2015 that were publicly listed over decade expended \$3.7 trillion on stock buybacks, representing 52.5% of net income, plus another 35.7% of net income on dividends. Much of the remaining 11.8% of profits was held abroad, sheltered from US taxes. Many of America's largest corporations routinely distribute more than 100% of net income to shareholders, generating the extra cash by reducing cash reserves, selling off assets, taking on debt, or laying off employees.

The earnings that a company retains after distributions to shareholders have always been the financial foundation for investment in innovation and sustained employment. These retained earnings can fund investment in plant and equipment, research and development, and training and retaining employees. If dividends alone are too high, investments in the company's productive capabilities will suffer. The addition of buybacks to dividends over the past three decades reflects a failure of corporate executives to develop strategies for investing in the productive capabilities of the companies that they manage.

Dividends are the traditional, and legitimate, way for a publicly-listed corporation to provide income to shareholders. Dividends provide shareholders with an income for (as the name says) *holding* shares. Moreover, if the firm retains enough of its profits to finance further investment in the company's productive capabilities, there is the

possibility (although by no means the certainty) that it will generate competitive products that will help lift its future stock price. When, for whatever reason, shareholders who have benefited from a stream of income on their holdings decide to sell some or all of their shares, they stand to make a capital gain.

In contrast, by creating demand for the company's stock that provides an immediate boost to its stock price, buybacks reward those shareholders for *selling* their shares. The most prominent sharesellers are those stock-market traders, including corporate executives, investment bankers, and hedge-fund managers, who are able to time their stock sales to take advantage of buyback activity done as open-market repurchases. Buybacks also automatically increase earnings per share (EPS) by decreasing the number of shares outstanding. Since EPS has become a major metric by which financial interests evaluate the performance of a company, buybacks tend to increase demand for a company's stock, thus creating opportunities for stock-market speculators to sell their shares at a gain, even in the absence of increased corporate revenues or profits.

BUYBACK IDEOLOGY

Corporate executives give a number of [reasons for doing buybacks](#). But all are deeply flawed.

- Executives claim that they are making an investment in the company because its stock is undervalued. But the evidence is overwhelming that most buybacks occur when stock prices are high, not when they are low.
- Executives claim that their companies do buybacks to offset dilution of earnings per share (EPS) that results when employees exercise stock options that they have received as part of their compensation. But if stock-based pay is supposed to induce employees to work harder and smarter, then those who receive it should have to wait until their efforts pay off in higher corporate earnings and stock prices rather than expecting to gain right away from buybacks that simply increase EPS by reducing the number of shares outstanding.
- Executives claim that buybacks are done when the company is mature and new investment opportunities have vanished. But any CEO who makes this argument is *not* doing his or her job of devising a strategy to invest in the company's future.

The only logical explanation for the prevalence of buybacks is that stock-based pay gives executives [ample incentives to do them](#). There are two main types of stock-based pay: stock options, in which the realized gains depend on the extent to which the stock price on the date the option is exercised exceeds the stock price on the date that the option was granted, and stock awards, which often vest if and when a company hits specified EPS targets.

By using stock buybacks to boost stock prices, executives can augment the gains that they realize from exercising stock options. By using stock buybacks to reduce the number of the company's shares that are outstanding, executives can augment the

number of shares that they receive from the vesting of stock awards based on EPS “performance.” From 2006 through 2014, the average annual total pay of the 500 highest-paid US executives (not including high-end outliers) ranged from \$14.4 million in 2009 to \$30.2 million in 2012, with realized gains from the combination of exercising options and vesting of awards making up from 66% to 82% of the total.

Proponents of stock-based pay argue that these incentives align the interests of corporate executives with those of shareholders. But the use of buybacks to boost stock prices represents an alignment of interests *among sharesellers*, especially corporate executives, investment bankers, and hedge-fund activists, who gain from manipulation of the stock market.

BUYBACK WINNERS

The financial gains that are reaped by the use of buybacks to manipulate stock prices represent an important explanation for the growing proportion of national income going to the [richest 0.1%](#) of households. A large proportion of these households occupy their elite positions by virtue of the remuneration that one or more of their members receive as executive employees of major US business enterprises.

Besides top corporate executives, the other big winners from stock buybacks are investment bankers and hedge-fund managers. Stock buybacks give manipulative boosts to a company’s stock price. Neither the SEC nor the general public knows when buybacks are actually being done. But top executives do, and investment bankers and hedge-fund managers are in the business of figuring it out and timing their stock trades to profit from it. When we delve into the financial behavior of a company with a major buyback program, we almost always find a hedge fund that has taken a shareholding stake in the company to encourage the pumping up of stock prices so that it can turn around and dump the stock for a significant gain.

But neither a hedge fund nor any other party that buys shares outstanding on the market – that is, shares that are not sold directly by a company in a public offering – provides the company with money that it can invest in productive capabilities. Without having contributed anything to a company’s development or success, hedge funds seek to extract from companies money that other people have generated. In effect, tens of millions of Americans go to work every day to create value in the companies that employ them, only to have this value extracted by stock-market speculators and manipulators who have typically played [little if any role](#) in the value-creation process.

These speculators and manipulators claim that they are reallocating the cash distributed from corporations to superior productive uses. In fact, these gains give them more financial muscle to demand more distributions of corporate cash to shareholders, shifting more of the economy’s resources from productive activity to financial activity and further enriching themselves. In 2014, the top 25 hedge fund managers reaped [a combined \\$11.2 billion](#) in personal income, or an average of almost \$450 million each, which was down almost 50% from \$21.5 billion, or \$860

million each, in 2013. We do not know how much of the hedge-fund “earnings” derive from “pump-and-dump” buyback-propelled gains. But we do know that almost all buybacks are about extracting value from companies, not about creating value in them.

BUYBACK LOSERS

Losers from buybacks are *households in their capacity as employees* whose skills and efforts enable a company to generate competitive products and hence make profits. These workers, blue-collar and white-collar, should be sharing in profits if and when they occur. When financial interests who have nothing to do with this value-creation process buy the company’s outstanding shares and demand distributions of corporate cash, they are helping themselves to funds that should be providing the stable employment and rising wages that are the foundations of a robust middle class. Indeed, through the trillions of dollars spent on buybacks, the concentration of income among the top 0.1% of households and the ongoing erosion of middle-class employment opportunities are [integrally related](#).

Losers from buybacks are *households in their capacity as taxpayers* who, through various government agencies, fund investments in physical infrastructure and human knowledge without which businesses could not operate. When companies are profitable, but do buybacks while avoiding taxes, households as taxpayers do not get a fair return on the investments that they have made.

Losers from buybacks are *households in their capacity as savers* that depend on a stream of dividend income plus long-run growth in stock prices to augment their employment incomes and support themselves in retirement. Any shareholder who expects to generate income by holding shares for the long term, whether directly or through a mutual fund or pension fund, should be opposed to buybacks, since the gains from them go to those who are in the business of timing share sales to take advantage of short-term stock-price changes. While benefiting sharesellers, buybacks jeopardize the stream of dividend income and long-term capital gains that households as savers should expect from their shareholdings.

Losers from buybacks are *households in their capacity as consumers*. Especially in industries such as health-care delivery that supply necessities, the high prices that companies can charge consumers often serve only to finance buyback activity.

Research on particular industries and companies shows clearly why almost everybody pays the price for stock buybacks.

- Pharmaceutical companies in the United States charge drug prices that are twice as high as anywhere else in the world, claiming that they use these higher revenues to spend more on R&D that generates medical innovation. Yet many of the largest US drug companies such as [Pfizer, Merck, and Amgen](#) have persistently distributed well over 100% of their profits to shareholders as buybacks and dividends.

- Many [health insurance companies](#) such as UnitedHealth Group, Aetna, and Wellpoint charge Americans high premiums and out-of-pocket expenses while spending upwards of 70% of net income on buybacks. Meanwhile, their executives reap tens of millions of dollars in stock-based pay.
- [High-tech companies](#) such as IBM, HP, Intel, Microsoft, and Cisco lay off thousands of experienced employees while doing billions of dollars in buybacks – and failing to invest sufficiently in future innovation. Handing out cash to shareholders while simultaneously laying off workers – a mode of resource allocation captured by the phrase “downsize-and-distribute” – stands in direct opposition to the [“retain-and-reinvest”](#) strategy through which a company provides its workers with employment stability so that they can accumulate the productive capabilities that are essential to innovative enterprise.
- [Petroleum-refining companies](#) such as Exxon Mobil – which leads all companies worldwide in repurchases at about \$22 billion per year – Chevron, and ConocoPhillips do massive stock buybacks while taking government subsidies for oil exploration and neglecting investments in alternative energy.
- [General Motors](#), which spent over \$20 billion on buybacks from 1986 to 2002 while losing market share to foreign competitors, agreed to do \$5 billion in buybacks in 2015 and 2016 after a group of hedge funds, represented by the main architect in the Obama administration’s 2009 bailout of GM, demanded \$8 billion in buybacks and a seat on the GM board. This demand came after US taxpayers took an \$11 billion loss bailing GM out of bankruptcy, while autoworkers gave up multiples of that amount in lost jobs, wage concessions, and retiree benefit reductions.
- Over the past decade [McDonald’s](#) has done almost \$3 billion per year in buybacks while its shareholders have received very high dividend yields. With revenues falling, McDonald’s [recently announced](#) its intention of increasing its annual buybacks as part of its “turnaround” plan. With the corporation bent on “maximizing shareholder value,” McDonald’s franchisees bear the costs of store renovations and product promotion while squeezing already low-paid workers to try to eke out profits.
- The only time in its history that Apple, now the most profitable company in the world, has raised funds from the public stock market was in 1980, when its initial public offering [brought in \\$97 million](#). Yet at the [behest of hedge-fund activists](#) David Einhorn and Carl Icahn, Apple has done \$80 billion in buybacks in two and a half years (through March 2015), thus [forgoing a golden opportunity](#) to provide leadership to corporate America in ensuring the allocation of resources to workers and taxpayers who actually have contributed, and continue to contribute, to the company’s success.

BUYBACK POLICY

The adoption of SEC Rule 10b-18, which is highly permissive of buybacks, was a direct result of the election of Ronald Reagan to the US Presidency on a platform of market deregulation. Wall Street executive John Shad, who Reagan appointed to [head the SEC](#),

argued that Rule 10b-18 would help fuel stock prices. At the same time, Shad adhered to the free-market notion that the costs of regulation outweigh the potential gains from the detection of illegal activity. From this perspective, a requirement for companies to disclose their daily buyback activity would undermine the efficiency of capital markets.

On its website the SEC states that it [“protects investors, maintains market integrity, and facilitates capital formation.”](#) In permitting, and even encouraging, buybacks that manipulate the stock market, however, the SEC has been undermining its own stated mission. Rule 10b-18 should be rescinded, and manipulative stock buybacks should be banned.

Any campaign to ban stock buybacks must raise questions about executive pay. At stake is not just, or even primarily, the excessive remuneration that top corporate executives reap: What is crucial is that stock-based pay incentivizes these executives to allocate corporate resources in ways that enrich financial interests, including Wall Street traders and themselves, at the expense of productive interests, including American households as workers, taxpayers, savers, and consumers. [Executive pay](#) needs to be structured so that it incentivizes and rewards value creation in the productive economy, not value extraction in the financial economy.

That the United States permits investment banks and hedge funds to reap where they have not sown says much about how regulation of the financial markets has failed since the US economy was almost brought to its knees by the Great Financial Crisis. A good part of the blame falls to economists, both liberal and conservative, who have failed to understand the difference between [value creation and value extraction](#), and as a result have espoused, or at least have failed to confront, the omnipresent ideology of “maximizing shareholder value.” An understanding of the role of buybacks in the allocation of the economy’s resources reveals that shareholder-value ideology provides a rationale for tearing down, not building up, an innovative economy.

Buybacks are at the core of what I have called the “downsize-and-distribute” economy. Government policy to regulate the stock market for the sake of a thriving middle class must build on [an economic perspective](#) that comprehends the centrality of “retain-and-reinvest” to the attainment of stable and equitable economic growth.

BUYBACK POLITICS

Stock buybacks are not new to the US economy. They were of only minor importance coming into the 1980s, but by the last half of that decade they had already become massive. Yet until very recently the phenomenon has received scant attention from US politicians.

The only instance that I have been able to find of Congressional concern with the issue prior to 2014 occurred in the summer of 2008, when Senators Charles Schumer (D-NY) and Robert Menendez (D-NJ) and Representatives Rahm Emanuel (D-IL) and Ed

Markey (D-MA) [took aim at stock repurchases](#) by the big oil companies following Exxon Mobil's announcement of record second-quarter profits of \$11.7 billion, of which \$8.8 billion went to buybacks. Sen. Schumer was [quoted](#) as saying: "[The big oil companies] tell us they want to do more domestic production. They tell us they need to drill offshore. They tell us that they can find oil on the mainland. And what do they do with their profits? They buy back stock, simply to increase their share price." In a letter to oil industry executives, the Congressmen asked them to "pledge to greatly increase the ratio of investments in production and [alternative energy] to the amount of stock buybacks this year and next by investing much more of your profits into exploration and production on the leases you have been awarded in the U.S., and in the research and development of promising alternative energy sources."

There is no evidence that the oil industry executives paid any attention to this plea. And despite widespread concern with the machinations of Wall Street in the wake of the financial meltdown that was unfolding in 2008 even as the Congressmen berated the oil companies, discussion of stock buybacks was entirely absent from the policy debates on financial reform. In the 832 pages of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the term "stock market" is never mentioned, much less "stock repurchases," "stock buybacks," "stock awards," or "restricted stock." On page 529, there is one parenthetical reference to "stock options." Yet there is no doubt that the trillions upon trillions of dollars that have flowed out of value-creating companies to investment banks and hedge funds over the past three decades have funded the too-big-to-fail gambling casino known as Wall Street.

The recovery from the Great Financial Crisis has been marked by what I have called ["profits without prosperity."](#) With concern growing over extreme concentration of income among the richest households and the relentless erosion of middle-class employment opportunities, even in recovery, a few politicians and public figures have begun to pay attention to the problem of stock buybacks.

In September 2014, at a [US Senate hearing on economic inequality](#), Sen. Elizabeth Warren (D-MA) invoked distributions to shareholders as the fundamental reason for the decline of shared prosperity in the United States since the 1980s. In a [penetrating speech](#) on "the unfinished business of financial reform" delivered in April 2015, she argued that "we can put in place strong, enforceable securities rules that don't create incentives for CEOs to use stock buybacks as a way to manipulate prices in the short-term, rather than investing in the long-term health of their companies." In [a Boston Globe interview](#) in June, she was highly critical of corporations for practicing, and of the SEC for permitting, stock-price manipulation by the use of buybacks.

On April 23, 2015, Sen. Tammy Baldwin (D-WI) wrote a [letter to SEC Chair](#) Mary Jo White "with concerns about the recent explosion of stock buybacks by U.S. corporations." Sen. Baldwin requested that the SEC, "as the regulator responsible for fair and efficient capital markets, provide the following: any analytic work done by the SEC on the long-term economic impact of the 1982 rule [i.e., Rule 10b-18]; an accounting of all investigations undertaken by the SEC into possible violations of the

rule; and an assessment of whether this rule is adequate for the SEC's stated mission – to foster capital formation and prevent fraud.”

In her [response](#) to Sen. Baldwin in a letter of July 13, 2015, SEC Chair White had nothing to say about the long-term impacts of Rule 10b-18, including its implications for capital formation and fraud prevention. She informed the Senator that, for SEC economists, “[p]erforming data analyses for issuer stock repurchases presents significant challenges because detailed trading data regarding repurchases is not currently available.” Why are these critical data lacking? A key feature of Rule 10b-18, as we have seen, is that it does not require that companies disclose the particular days on which they do stock buybacks.

Chair White did say that while the SEC has “a long history of bringing enforcement actions against persons alleged to have manipulated common stock prices,” it could not investigate possible violations of Rule 10b-18. Why? As Chair White explained: “Because Rule 10b-18 is a voluntary safe harbor, issuers cannot violate this rule.” In other words, Rule 10b-18 is a license to use open-market repurchases to manipulate stock prices.

Notwithstanding Chair White's admission that the SEC is [not monitoring buybacks](#) to prevent market manipulation, one sign of progress at the SEC was Commissioner Kara M. Stein's [speech](#), “Toward Healthy Companies and a Stronger Economy,” delivered in April 2015. Commissioner Stein observed that “companies [have] become overly focused on meeting quarterly earnings targets. They may regularly offer up large amounts of a company's earnings as payouts to shareholders.” Commissioner Stein cited the \$3.4 trillion on buybacks that 454 companies in the S&P 500 Index distributed in 2004-2013. “That's an awful lot of cash,” she observed. “Why are they deploying their cash in this fashion?”

One would have thought that US labor unions would be asking this question. Yet, for some reason, until very recently, the American labor movement and its associated think tanks have ignored the buyback phenomenon. That may be changing. At the end of a presentation at the *Christian Science Monitor* in late August 2014, AFL-CIO president [Richard Trumka](#) asked if he could take a few final minutes to “drop one in your laps.” He focused his remarks on the double standard that condones multi-million-dollar stock-based executive pay, pumped up by multi-billion-dollar buybacks, while accusing workers of being greedy for asking for a two-dollar increase in the minimum wage or a \$31,000-per-year pension.

In May 2015, to my knowledge for the first time, a US union confronted stock buybacks as an issue integral to its organizing strategy. At the request of the Service Employees International Union (SEIU), the Academic-Industry Research Network wrote a [report on McDonald's buybacks](#) – which, as mentioned previously, have totaled almost \$30 billion over the past decade – and their [negative impacts](#) on the company's franchisees, employees, and institutional shareholders. At a 5000-strong worker protest in late May at the site of McDonald's annual shareholders meeting,

SEIU President [Mary Kay Henry](#) said: “It’s time for McDonald’s to respect workers on the front lines as much as they have respected shareholders by putting \$30 billion in their pockets over the last 10 years.” In the context of the McDonald’s protests, the comptrollers of New York City and New York State, the controller of California, and the treasurer of Chicago, who represent a combined [\\$860 billion in pension assets](#), expressed concern that buybacks were being done at the expense of investment in enterprise growth.

Since then, the buyback problem has entered the campaigns for the Democratic presidential nomination. Sen. Bernie Sanders (I-VT) was first out of the gate in June with an [op-ed in the Boston Globe](#) (alongside [one of mine on buybacks](#)) which followed a [major front-page story](#) by journalist Michael Kranish on the damage that buybacks can do. Sen. Sanders wrote: “Instead of putting resources into innovative ways to build their businesses or hire new employees, corporations are pumping their record-breaking profits into buying back their own stock and increasing dividends to benefit their executives and wealthy shareholders at the expense of their workers.”

So too, on July 13, buybacks found their way into Hillary Clinton’s first major economics speech of her campaign to be the Democratic presidential nominee. As [she phrased it](#): “In recent years some of our biggest companies have spent more than half their earnings to buy back their own stock and another third or more to pay dividends. That doesn’t leave a lot left to raise pay or invest in the workers who made those profits possible or to make new investments necessary to ensure a company’s future success.” Later she continued: “I will also propose reforms to help CEOs and shareholders alike to focus on the next decade rather than just the next day. Making sure stock buybacks aren’t being used only for an immediate boost in share prices; empowering outside investors who want to build companies, but discouraging cut and run shareholders who act more like old-school corporate raiders. And nowhere will the shift from short-term to long-term be more important than on Wall Street.”

Clearly, as Harold Meyerson put it in a [Washington Post](#) article on the Clinton speech, Clintonomics had been pushed to the left. He noted the recent publication of a [Brookings paper](#), “More Builders and Fewer Traders: A Growth Strategy for the American Economy,” by William Galston and Elaine Kamarck, two former advisors to Bill Clinton, that, drawing on [a paper](#) that I wrote for Brookings Center for Effective Public Management, calls for the repeal of SEC Rule 10b-18 and the regulation of executive pay.

On July 24, Clinton delivered [a speech](#) in which she laid out a policy platform to confront the pervasive culture of “quarterly capitalism.” Her [list of policy reforms](#) (upon which she promised she would elaborate as her campaign unfolds) to replace “short-termism” with “long-termism” focuses on five areas: capital-gains taxes, stock buybacks, executive pay, empowering workers, and stable pro-growth government policy.

Citing my *Harvard Business Review* article, "[Profits Without Prosperity](#)," Clinton declared: "We also have to take a hard look at stock buybacks. Investors and regulators need more information about these transactions. Capital markets work best when information is promptly and widely available to all. Other advanced economies like the United Kingdom and Hong Kong require companies to disclose stock buybacks within one day, but here in the United States you can go an entire quarter without disclosing. So let's change that."

In the absence of a repeal of Rule 10b-18, full disclosure makes sense. Under Rule 10b-18, companies need not disclose the actual amount of buybacks that they do on any given day, either at the time when they are done or after the fact. If the SEC is going to continue to permit open-market repurchases by companies, it should at least require each company to reveal immediately, on a daily basis, how much it has done on any given day so that the agency and the public can assess whether stock-price manipulation is going on. It would then also be transparent if executives and other insiders have timed the sales of their own personal holdings of the companies' shares (including those acquired from exercising stock options or the vesting of stock awards) to take advantage of price boosts from buyback activity.

Yet, [far from reducing short-termism](#), Clinton's buyback proposal might only serve to incentivize it. Demanding no more than prompt disclosure of actual buyback activity would leave intact the safe harbor that enables a company to repurchase on any one day up to 25% of its stock's average daily trading volume over the previous four weeks – a "limit" which is a [license to manipulate](#) the stock market. The rapid and open disclosure of when a company is actually doing buybacks might do no more than give all types of shareholders a better chance of gaining from stock-market manipulation, removing the knowledge advantage in this regard that senior executives and hedge-fund managers now possess.

We do not want to encourage even more shareholders to time the market for short-term gain by selling their shares, and we do not want to encourage companies to cater to shareholders who have this objective. Creating more "efficient" capital markets does not do much good if the purpose of those capital markets is, as is currently the case, value-extraction, not value-creation. If Clinton wants to attack short-termism, she should call for the repeal of SEC Rule 10b-18.

Rule 10b-18 dates back to 1982. To repeat, the buyback problem is not new; it has been afflicting the US economy for three decades now. But the political concern with buybacks is very new, and the politicians who have come to recognize the problem must now make a quick transition from buyback basics to buyback policy.

There is no doubt in my mind that the problem of buybacks will become better understood by presidential hopefuls as the campaign for the White House unfolds, and I certainly hope that the regulation, and even elimination, of buybacks will become central to a policy agenda for bringing stable and equitable growth to the US

economy. In addressing a complex problem, there are a few straightforward messages that should resonate with the electorate:

- Massive buybacks, piled on top of dividends, are depriving companies of the retained earnings that have always provided the financial foundation for a prosperous corporate economy.
- Buybacks are making a major contribution to the growing concentration of income among the richest households.
- Buybacks undercut investment in the productive capabilities of the labor force that are essential for achieving stable employment with decent pay.
- Buybacks constitute a manipulation of the stock market that leaves most Americans worse off.
- For over three decades now, since the first term of Ronald Reagan's presidency, the government agency that is supposed to regulate the stock market has, through (the once-obscure) Rule 10b-18, promoted the looting of business corporations for the sake of stock-price manipulation.

Buybacks are at the center of American inequality because corporate resource allocation is at the core of the economy. Let's launch a campaign for a return to stable and equitable growth by rescinding SEC Rule 10b-18. Let's transform the SEC from being a Reaganite promoter of the stock market to a [Democratic president to be determined] regulator of the stock market. That is just a start, but it is a first step that is not only essential but also achievable.

About the Author

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The Institute for New Economic Thinking, Ford Foundation, and European Commission are currently funding Lazonick's research. His book *Sustainable Prosperity in the New Economy? Business Organization and High-Tech Employment in the United States* (Upjohn Institute for Employment, 2009) won the 2010 International Joseph A. Schumpeter Prize. His article, "Innovative Business Models and Varieties of Capitalism," received the Henrietta Larson Award from Harvard Business School for best article in *Business History Review* in 2010 (Lazonick had previously won the prize for best article in this journal in 1983). His *Harvard Business Review* article "Profits Without Prosperity: Stock Buybacks Manipulate the Market and Leave Most Americans Worse Off," received the HBR McKinsey Award for outstanding article in *Harvard Business Review* in 2014. Lazonick is currently completing a book, *The Theory of Innovative Enterprise*, to be published by Oxford University Press.

About theAIRnet

The Academic-Industry Research Network – theAIRnet – is a private, 501(c)(3) not-for-profit research organization devoted to the proposition that a sound understanding of the dynamics of industrial development requires collaboration between academic scholars and industry experts. We engage in up-to-date, in-depth, and incisive research and commentary on issues related to industrial innovation and economic development. Our goal is to understand the ways in which, through innovation, businesses and governments can contribute to equitable and stable economic growth – or what we call “sustainable prosperity”.

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