Corporate stock buybacks are booming, thanks to the Republican tax cuts

Republicans said their tax bill would go to workers. Instead, it’s going to Wall Street.

By Emily Stewartemily.stewart@vox.com Mar 22, 2018, 8:50am EDT

House Speaker Paul Ryan arrives to speak about the Republican tax cuts in December. *Mark Wilson/Getty Images*

Right after Republicans in Congress passed their tax bill, lowering tax rates on corporations, companies delivered a very public thank-you: a series of bonus and investment announcements. It was a major PR opportunity for both corporate America and the GOP, meant to show that American businesses were sharing their billions of dollars in tax cut savings with their workers and the broader economy.

But over the next few months, the real winners from the corporate tax cut became clear — not workers and consumers, but shareholders. Companies have boosted dividends and stock buybacks. A stock buyback is when a company buys back its own shares from the broader marketplace.

The $1.5 trillion GOP tax cut is a major boon to corporations. It slashed the corporate tax rate to 21 percent from 35 percent, reduced the rate on corporate income brought back to the United States from abroad to between 8 and 15.5 percent instead of 35 percent, and exempted American companies' foreign income from US tax.

The bill's proponents say it will boost the economy, boost wages, and create jobs. "This is the kind of tax reform and tax cuts that get our economy growing to reach its potential," House Speaker Paul Ryan said when celebrating the law's passage at an event on the White House lawn in December. "This gets us better wages, bigger paychecks, a simpler tax system. This gets the American economy competitive in the global economy. This is one of the most important things we could do for all of the people we represent."

But companies have been eager to put the savings they've reaped from the new tax law into their shareholders' pockets.

A Bloomberg analysis found that about 60 percent of tax cut gains will go to shareholders, compared to 15 percent for employees. A Morgan Stanley survey found that analysts estimate 43 percent of tax cut savings will go to stock buybacks and dividends, while 13 percent will go to pay raises, bonuses, and employee benefits. Just Capital's analysis of 121 Russell 1000 companies found that 57 percent of tax savings will go to shareholders, compared to 20 percent directed to job creation and capital investment and 6 percent to workers.

Americans are much likelier to see a notable difference in their stock portfolios than in their paychecks — that is, if they have them. According to Gallup, just over half of Americans own stocks at all. What's more, the richest 10 percent of Americans own 80 percent of all stock shares. The bottom 80 percent of earners own just 8 percent.

Stock buybacks used to be illegal. Now they're a major part of how companies spend their cash.

Stock buybacks occur when companies repurchase shares of their own stock. That leaves remaining shareholders with a bigger chunk of the company and increases the earnings they reap per share. Vox's Matt Yglesias recently laid out how they work:

> When companies first go public (i.e., stage an initial public offering), stock is made available for purchase by the broad public on the main stock markets. In principle, the sale of the stock can be used to raise money for investment. More typically, the point of the IPO is to give the early investors in the company — venture capitalists, early employees, and founders — the opportunity to get their hands on cash so they can begin to enjoy the fruits of their work.
>
> A stock buyback is basically a secondary offering in reverse — instead of selling new shares of stock to the public to put more cash on the corporate balance sheet, a cash-rich company expends some of its own funds on *buying* shares of stock from the public.

Since the tax bill, companies have been doing a lot of buybacks. Share buybacks in 2018 have averaged $4.8 billion per day, double the pace from the same period last year, according to an analysis the market data firm TrimTabs provided to CNBC.

Goldman Sachs in February estimated S&P 500 firms will return $1.2 trillion to shareholders via buybacks and dividends in 2018, increasing share buybacks by 23 percent to $650 billion this year.

The tech conglomerate Cisco, which had more than $70 billion cash parked overseas prior to the tax cut, in February said it would bring back some of that money and put an additional $25 billion toward a stock buyback. The megabank Wells Fargo in January announced about $22 billion in buybacks. Pepsi announced a $15 billion buyback, Amgen and AbbVie $10 billion, and Google's parent company Alphabet $8.6 billion.

Buybacks were illegal throughout most of the 20th century because they were considered a form of stock market manipulation. But in 1982, the Securities and Exchange Commission passed rule 10b-18, which created a legal process for buybacks and opened the floodgates for companies to start repurchasing their stock en masse.

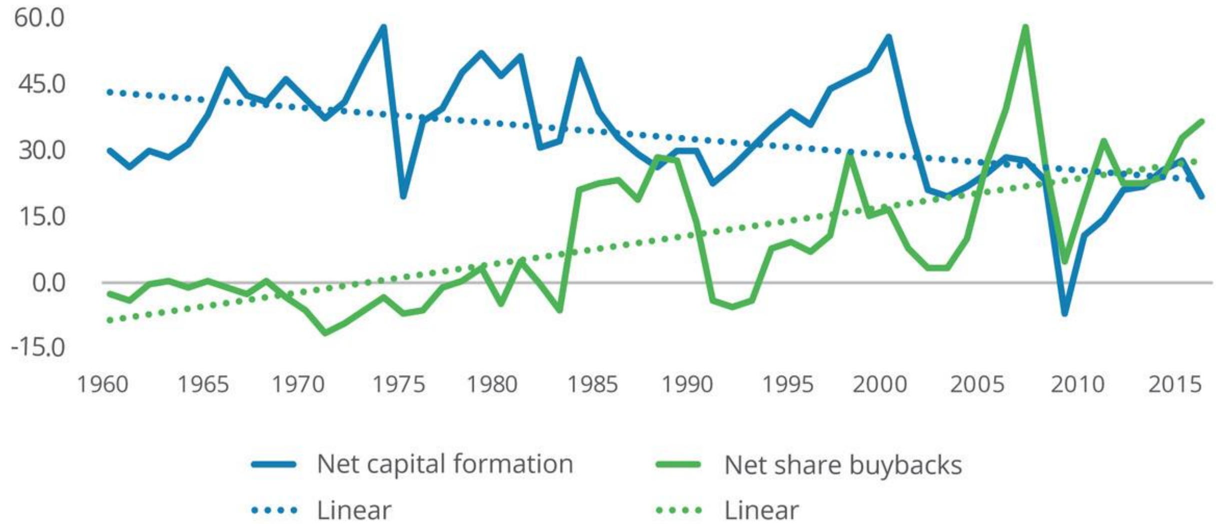
There's a lot of debate about whether buybacks are a good thing or a bad thing. Proponents note that they are, indeed, money going back into the economy, and they lead to a rise in stock prices, which can have a marginally positive effect on consumer confidence and consumption. And shareholders are, obviously, people — albeit not the majority of them. Again, about 80 percent of all stocks are owned by the richest 10 percent of Americans.

Detractors, however, warn that buybacks could worsen wealth inequality. "Stock buybacks have been a prime mode of both concentrating income among the richest households and eroding middle-class employment opportunities," William Lazonick, a professor at the University of Massachusetts Lowell, recently told CNN Money.

Buybacks may not be the end of the world, but they do result in corporations giving billions of dollars to their shareholders instead of investing in something more productive and broadly beneficial to the economy.

Deloitte researcher Lester Gunnion recently pointed out that share buybacks and dividends have been increasing in recent years while business investment is on the decline. There is concern that businesses are swapping one for the other.

Figure 3. Net share buybacks and net capital formation as a share of net operating surplus for nonfinancial corporations



Source: "Integrated macroeconomic accounts of the United States," Bureau of Economic Analysis.

Deloitte Insights | deloitte.com/insights

The tax bill didn't create buybacks — but it's making them bigger

Thanks to the tax cuts, corporations are now flush with even more cash to return to their shareholders. But shareholder primacy isn't a new phenomenon: Birinyi Associates, a market research firm, has tracked $9.9 trillion in stock buyback announcements since 1984. Since 2008, $5.6 trillion in buybacks have been announced.

But this year is on track to be even bigger: Birinyi has tracked $201 billion in buyback announcements so far this year, the "record highest" at this point in time compared to other years, Chris Costelloe an equity trader there, said in an email. JPMorgan Chase analysts have estimated buybacks could reach more than $800 billion this year, well up from $530 billion in 2017 and even surpassing 2007's all-time high of just under $700 billion.

"The tax plan is just the latest in a long line of really bad economic policies that are based on an idea of how corporations work that has nothing to do with how corporations actually work today," Nell Abernathy, vice president of research and policy at the liberal-leaning think tank the Roosevelt Institute, told me. "The idea that we can just return capital to companies and that will trickle down and grow the economy, that may have been true at some point — I'm skeptical — but so much has changed in the way that companies allocate capital."

There are a variety of explanations for why corporations aren't investing in their workers or business operations and are increasingly valuing shareholders instead.

New York University researchers Germán Gutiérrez and Thomas Philippon in a recent working paper for the National Bureau of Economic Research examined possible reasons for lower-than-expected corporate investments in the United States since the early 2000s. They determined decreased competition, tightened corporate governance, and short-term pressures are in play. In other words, companies don't face enough competition to force them to actually invest in improving their businesses, and they're increasingly paying attention to what's happening in the boardroom and pressure from shareholders to make money fast.

And the GOP tax bill is exacerbating the trend. Stock buybacks are up. Mergers and acquisitions, which fuel consolidation, are on the rise as well: In the first few weeks of January alone, 11 deals worth more than $5 billion were announced. Billionaire investor Warren Buffett, whose conglomerate Berkshire Hathaway made $29 billion off the tax cuts, is now sitting on a record $116 billion in cash and is looking for deals at a "sensible purchase price." (It's worth noting that mergers and acquisitions often benefit shareholders too, if the combined companies become more profitable. For shareholders of the company being bought, an acquisition can help them if the purchaser offers a higher price for their shares than they bought them for.)

"There are two forces that are simultaneously working to shift profits away from investment in capital equipment or research or workers or productive activities that grow the economy," Abernathy said. "One is shareholder primacy in general, shareholders putting pressure on firms to issue buybacks and dividends. The other is the lack of competition."

If you're not a shareholder, the tax bill hasn't done much yet

Critics warned that buybacks, deals, and other measures that benefit shareholders were a likely outcome from the tax bill and would take precedence over investments that boost the economy and workers. House Minority Leader Nancy Pelosi at a January press conference said the money corporations were giving to workers would pale in comparison to what they would give to those who own their stock. "I would hope that with their big advantage of bringing money home at a very low rate that they would invest in infrastructure and things, but our experience has been that they will do dividends, they will do stock buybacks, and things like that," she said.

If the tax bill is having an effect on wages or capital investments thus far, it's just not that noteworthy. Wage growth reached 2.9 percent from the year prior in January, its best pace since 2009, but slowed to 2.6 percent in February. Unemployment remains low at 4.1 percent, but it's been declining for years.

Manufacturers' new orders for non-defense capital goods (tangible assets such as buildings, equipment, and machinery), excluding aircraft, fell for the second consecutive month in January. "We should be seeing some serious upticks in orders if the tax cut is going to lead to the promised jump in investment," Dean Baker, an economist from the liberal-leaning Center for Economic and Policy Research, said in an email.

Orders are up year over year, but that is to be expected, he said, because the economy has been and is growing. "The question is whether there is some additional boost to growth associated with the tax cut," Baker said. "The data on orders for the first two months that the cut was known for certain are hardly conclusive, but [Republicans'] projections implied a huge — e.g., 30 percent — increase in investment. To date, we're going the wrong way."

But again, none of this is really a surprise. In 2004, President George W. Bush gave corporations a one-time tax holiday for them to bring back earnings to the US at a reduced tax rate; three years later, companies used that money as follows: 47 percent went to mergers and acquisitions, 37 percent to buybacks, and 13 percent went to debt payments. Companies increased capital expenditures by 10 percent and research and development by 7 percent.

Republicans think their tax bill will be an easy sell on the campaign trail. They might be wrong.

Republicans are banking on the tax cuts to help them win elections and sway voters heading into the 2018 midterms. But that might be easier said than done. Republicans initially focused on the tax cut messaging in the recent special election in Pennsylvania's 18th Congressional District, but by election day, they had pivoted to decrying so-called "sanctuary cities" after determining the tax message wasn't breaking through. (The Republican candidate, Rick Saccone, lost to Democrat Conor Lamb.)

A February Politico/Morning Consult poll found that most Americans aren't noticing a tax cut in their paychecks. House Speaker Ryan was hammered on Twitter after he tweeted out an item about a public school employee who, thanks to the tax bill, got an extra $1.50 in her weekly paycheck. He later deleted the tweet.

When you compare that extra $1.50 to literally billions of dollars in stock buybacks — well, you get the point. "Overwhelmingly, corporations are spending their tax cuts to benefit investors — not raise workers' pay, as Trump and Republicans promised," Andrew Bates, a spokesperson for the Democratic Super PAC American Bridge, said in an email. "The GOP has pinned their 2018 strategy on marketing a delusion, and voters see through it — including the 2016 Trump voters in Pennsylvania's 18th district who'd been calling the tax plan a 'giveaway to the rich' weeks before Republicans were trounced in a place Trump won by 20 [points]."

The Super PAC plans to intensify its attacks on Republicans over taxes in more races following the Pennsylvania results.

The thing is, there are ways for policymakers to make sure companies share the wealth they're reaping from the tax cuts with more stakeholders than their investors. Sen. Cory Booker (D-NJ) recently unveiled legislation that would curb how companies do buybacks and force them to share some with workers.

"I personally wish they had done more to directly link corporate rate reductions and pass-throughs, for that matter, to real and tangible benefits for employees, things like IRA matching or employee profit sharing or employee ownership," Dean Zerbe, managing director at the tax consultancy Alliantgroup and former tax counsel to the Senate Finance Committee, told me last year. "They would have had a better and easier time of selling it and convincing folks that this was real. Now, they're just going to have to hope that all their words come to fruition."